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Global Practice Guides

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Chambers Global Practice Guides

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INTRODUCTION

Contributed by: Maura O'Sullivan, Michael Chernick, Shameer Shah and Shawn Dogra, **Shearman & Sterling**

Shearman & Sterling is a global law firm that partners with corporations, major financial institutions, emerging growth companies, governments, and state-owned enterprises to provide the legal and industry insight needed to navigate the challenges of today and achieve their ambitions of tomorrow. For 150 years, Shearman & Sterling has built strong and long-lasting relationships with clients around the world by advising on groundbreaking, precedent-setting matters across industries and sectors. The firm has over 700 lawyers around the world speaking more than 65 languages, and nearly half of its lawyers practice outside the United States. The firm is committed to forging long-term relationships with its clients by providing genuine insight and practical advice as they navigate the challenges of the 21st-century global economy.

Contributing Editor

Maura O'Sullivan is a partner in the finance practice at Shearman & Sterling. She focuses on acquisition financings, leveraged lending, restructurings, debtor-in-possession financings and asset-based finance. Maura has extensive experience representing financial institutions and direct lenders in structuring and executing acquisition financings, leveraged lending, first- and second-lien structures. She also has significant expertise in restructuring transactions, debtor-in-possession financings and asset-based finance. Maura has also worked extensively in cross-border financings (including in connection with cross-border acquisitions).

Co-authors

Michael Chernick is a partner in the finance practice at Shearman & Sterling. Michael has over 25 years of experience in the US leveraged finance market, representing leading investment and commercial banks, alternative capital providers and other financial institutions in bank financing and debt capital markets transactions. He has extensive experience in public and private leveraged and investment grade acquisition finance (including bridge financings), refinancings and recapitalisations, second-lien and asset-based lending. Michael also advises on securities, capital markets, bank finance, and corporate transactions representing corporations and financial institutions in bank financings, public and private offerings and high-yield debt offerings.

INTRODUCTION

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Shameer Shah is a partner at Shearman & Sterling in the leveraged finance team in London. Shameer's principal focus is acquisition financings, rescue or stress financings and restructurings, working with a range of clients across financial sponsors, private credit, major investment banks and other financial institutions. Shameer has advised on all major financing structures, including unitranche, senior, second lien and mezzanine, PIK debt financings, as well as preferred equity and warrants.

Shawn Dogra is a senior associate in the finance practice of Shearman & Sterling. Shawn represents leading financial institutions and private capital providers as lenders and arrangers in a broad range of finance transactions, including complex syndicated loan transactions, acquisition and other leveraged financings, direct lending transactions, asset-backed financings, investment grade financings and in and out-of-court restructurings. Shawn also has significant experience advising corporate borrowers in finance matters.

Shearman & Sterling

599 Lexington Avenue
New York
New York
10022-6069
United States of America

Tel: +212 848 4000
Email: Shawn.Dogra@Shearman.com
Web: www.shearman.com

SHEARMAN & STERLING

INTRODUCTION

Contributed by: Maura O'Sullivan, Michael Chernick, Shameer Shah and Shawn Dogra, **Shearman & Sterling**

Overview: Muted Activity in a Challenging Environment

Leveraged finance activity in 2023 has followed in the footsteps of a difficult 2022 as we have continued to see muted overall activity globally amidst a challenging backdrop for the leveraged finance market. Macroeconomic factors, including rising inflation rates that have caused central banks across the globe to increase their benchmark rates and stoked fears of recession for most economies and significant bank failures or near failures, including Credit Suisse and Silicon Valley Bank, have created substantial challenges to returning to a more robust financing market. As a result of these and other factors, borrowers have faced elevated borrowing costs and generally tight credit conditions. There has been weaker M&A activity as these aforementioned factors have created a market where there are valuation gaps as buyers are reducing their valuations to take these dynamics into account and peak valuations from 2021 and 2022 are still top of mind for sellers who do not want to settle for less.

A dearth of new transaction supply in the US and EMEA primary markets is evident: the rise of borrowing costs and corresponding decline in M&A activity (and the private equity-backed leveraged buyout/acquisition financing pipeline) which began in 2022 has been exacerbated by a more selective lender base and by particular weakness in the broadly syndicated loan markets (with the overhang of several "hung" financings only beginning to clear in the first half as less than half of 2022's unsold debt remained at banks by mid-year (Wall Street Journal)). With syndicated loan markets virtually frozen and financing sources focused on leverage levels and tightening documentation, some acquisitions that traditionally would have been financed by the syndicated loan markets were financed by buyers (both strategic and private equity) through the private credit markets or simply without initial reliance on debt. Primary issuance in general has been dominated by maturity-driven refinancings and "amend-and-extend" transactions as companies have focused by necessity on repaying debt and extending maturities, while signs of market stress have grown with moderate increases in default rates, out-of-court restructurings and bankruptcy filings.

The market outlook remains uncertain but recent developments have provided some basis for cautious optimism. Resilient economic fundamentals, including cooling inflation figures, have helped to quell recessionary fears and concerns over the pace of central bank rate increases in the US in particular. It is a similar tale in Europe, with activity starting to pick up in the Nordics, Benelux and continental Europe in general, although the UK is still lagging somewhat behind. Secondary markets have shown significantly less volatility than in 2022 amidst positive returns and a gradual reopening of the broadly syndicated loan markets has become apparent, with successful syndications of opportunistic refinancings and "green shoots" of LBO activity by mid-year. Impending maturities remain likely to spur market activity: stronger borrowers may look to further capitalise on reopening markets, while companies struggling with higher borrowing costs (of which there is an increasing number) will need to turn towards alternative financing options or restructuring of their existing debt. Private credit lenders have also increasingly provided a valuable source of liquidity for borrowers, particularly through underwriting larger transaction sizes in the LBO market in the absence of syndicated options and seem poised to offer flexible financing options to borrowers across the risk spectrum.

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Some of the predominant themes seen so far this year are set out in further detail below.

Trends in a Selective and Shifting Market

The first half of 2023 has seen arrangers and issuers in the syndicated markets opportunistically launch refinancings and focus on "amend-and-extend" transactions while new acquisition financings (other than small add-ons) and other primary issuance have been at a virtual standstill, with a recovery in market confidence negatively affected for a period by the collapse of Credit Suisse and US regional bank collapses in March. However, market confidence was shored up by positive secondary market movements in subsequent months. Overall US institutional leveraged loan issuance volume at mid-year was down 35% year-over-year, with volume excluding refinancings at its lowest level since 2009 (Refinitiv, LCD). M&A financing was severely impacted by high borrowing costs and valuation disconnects: sponsors primarily executed opportunistic public-to-private acquisitions or small platform acquisitions for existing portfolio companies, and even when factoring in add-on financings, new M&A transactions accounted for only 18.5% of institutional leveraged loan activity (LCD). Syndicated market conditions favoured well-rated borrowers (with a pronounced shift in terms and pricing spreads at B3/B-, reflecting CLO concerns of downgrades below minimum acceptable levels) and favored conservative LBOs, with underwritten syndicated LBOs featuring lower leverage levels and higher equity contributions from sponsors than in prior years. Average equity contribution for US broadly syndicated LBOs had reached 67% by mid-year with average pro forma adjusted total leverage ratio at only 4.3x, matching levels last seen in 2017 (LCD, Covenant Review). Meanwhile, in EMEA leveraged loan issuance declined by 41.9% year-over-year, with new M&A transactions also down 42.75% year-over-year (Debtwire). Loan extensions are however running at a record high of EUR25.7bn (LCD).

Primary issuance noticeably shifted from institutional leveraged loans to high-yield secured bonds and private credit. A 17% year-over-year increase in US-secured notes issuance was seen by mid-year (CreditSights). This may have been driven by structural characteristics and market participant preference in this interest rate environment: secured bonds carry fixed-rate interest which provides both a level of borrowing cost certainty for borrowers and a certain coupon for investors relative to the floating-rate nature of bank debt. Secured bonds are also typically more expensive to call and are subject to call protection for a longer period than term loan B bank debt.

Private credit markets provided vital liquidity in the absence of syndicated options and expanded their presence across the risk spectrum during the year. Private credit providers took an increasingly larger share of the private equity LBO market pipeline globally, underwriting large public-to-private LBOs (notably including at least one major financing with borrower-friendly payment-in-kind functionality) and the majority of committed acquisition financings in the US and EMEA at mid-year (LCD). Financing these transactions in such periods of uncertainty meant that private credit lending syndicates grew larger, with sponsors forced to rely on a wider set of private lenders as lenders remained selective. Private credit lenders notably also provided various financing solutions to distressed or lower middle-market borrowers, including junior debt, but also expanded towards higher quality borrowers: a number of publicly-traded investment-grade borrowers globally turned to private credit for sizeable bespoke financing transactions. As market confidence grew over the last few months, several

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sponsor-backed acquisition processes included dual-track syndicated and private credit options, suggesting a borrower-friendly return to competitive tensions as the syndicated markets reopen. Moreover, the depth and scale of the private credit market and the relative dearth of new-money private equity acquisition financings, further exacerbated borrower-friendly terms.

LIBOR cessation (with the last USD Panel LIBOR rates published on 30 June 2023) was a source of significant activity in the leveraged loan market during the first half of the year with Term SOFR implemented as the new market standard reference rate. Market consensus for the credit spread adjustment necessary to reflect the difference between LIBOR and Term SOFR at relevant tenors settled on the ARCC-recommended spread adjustments of approximately 11, 26 and 43 basis points for one, three and six-month tenors for existing facility transitions despite some successful borrower-pushed variations as CLOs and other lenders co-ordinated in support of the ARCC-recommended adjustments. The credit spread adjustment for new SOFR facilities varies and remains unsettled, including options such as no spread adjustment, 10 basis points across tenors, 10/15/25 basis points or the ARCC-recommended spreads. Synthetic LIBOR (effectively Term SOFR plus the ARCC-recommended spreads) will be published by the IBA until 30 September 2024, providing additional time to transition "legacy" contracts that do not contain the "fallback" provisions contemplated by loan documentation in recent years.

Sustainability-linked leveraged loans, which typically tie the interest margin charged to compliance with certain key performance indicators (KPIs), continued to grow not only in the EMEA (where they have traditionally been more commonly seen) but also in the US. Standard practices emerging include independent third-party verification of compliance with KPIs and fixed timeframes for KPI implementation when flexible ESG amendment features are included (where KPIs are set at a later date following closing). Pricing structures tied to KPIs allow for both margin increase and decrease. The EU's Corporate Sustainability Reporting Directive (CSRD) – a mandatory framework requiring companies to file annual sustainability reports prepared in accordance with the European Sustainability Reporting Standards (ESRS) that were released mid-year – will further impact market practices towards measurement, verification and reporting. Advisory bodies such as the Loan Market Association and the Loan Syndications and Trading Association have also helped guide developments in standard provisions with updates to their sustainability principles and guidelines.

Restructurings and Defaults

Restructuring activity, loan defaults and bankruptcies have seen a pronounced uptick as signs of stress have continued to grow, although distress remains below historical highs. Covenant relief amendments were seen more frequently than in 2022. Continuing a trend dating back to mid-year 2022, loan rating downgrades continue to outpace upgrades. The US leveraged loan default rate was measured at 1.71% by amount by mid-year, an increase of 143 basis points from the same period last year (LCD). Chapter 11 filings in the United States, as tracked by FTI for facilities over USD50 million, doubled in the first half of 2023 year-over-year, while Debtwire reported a comparable year-over-year trend in the number of restructuring advisory mandates. Both metrics remained below recent high-water marks set in 2020.

Out-of-court restructuring activity has also grown rapidly relative to statutory proceedings

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in recent years: by the start of the year 72% of defaults were reported to have resulted in exchange transactions globally, up from nearly 50% in 2020 (Moody's). Leaving aside more typical exchange offers, borrowers have increasingly turned to "liability management transactions" to address capital structure concerns: these transactions generally include up-tiering transactions (where selected existing debt is up-tiered in priority and/or senior debt is inserted on a priority basis above an existing stack), drop-down/unrestricted subsidiary financings (where unencumbered assets or unencumbered subsidiaries are used to generate additional liquidity) and "double dip" transactions (where new lenders receive the security of both a direct claim against a company group and an additional claim from an intercompany financing arrangement of the loan proceeds). These transactions have been seen more frequently in the United States than Europe, and although not limited to sponsor-backed companies, have been more frequently utilised by sponsor-backed companies as a method of preserving the sponsor's equity investment that would otherwise be jeopardised in a statutory proceeding. Europe is, however, now starting to see liability management transactions being executed, or at least threatened, to coercively push through amendments by borrowers, as the impact of rising interest rates begins to take hold.

Future liability management transactions may find guidance from the US bankruptcy court's June ruling in Serta that upheld a contested up-tiering financing, particularly as the decision was the first of its kind on the use of "open market purchase" provisions to effect such transaction. The court affirmed that Serta's actions when entering into a financing transaction where certain lenders exchanged their existing first- and second-lien debt for second-out superpriority debt and also provided new first-out superpriority debt fell within the credit agreement's definition of "open market purchase" and thus Serta was not required to extend the exchange of first- and second-lien debt to excluded lenders. The court's focus on contractual language may encourage borrowers to be more aggressive in relying on the loose contractual provisions found in many recent credit agreements. Similarly structured up-tiering transactions were seen during the year and can be expected to increase if market stresses continue.

Conclusion

The past twelve months have seen a continuation of the challenges that first enveloped the global leveraged finance market in 2022, with the backdrop of a lack of confidence by market participants and tighter credit conditions reflected in both market activity and market documentation standards. An optimistic view is that improving macroeconomic fundamentals during the year, already reflected in secondary market valuations, may propel more primary activity as market confidence grows and M&A activity returns. Syndicated markets have signaled reopening and private credit lenders have become an increasingly crucial liquidity source, suggesting more competition will return to the benefit of borrowers. The market picture over the next twelve months may ultimately prove to be a tale of two markets – robust borrowers and acquisitive sponsors may be able to access primary markets and resume loosening documentation as in prior years while an increasing number of borrowers struggling with high borrowing costs, especially those operating under the shadows of looming maturities, will need to seek out alternative financings leveraging existing documentation flexibility or turn towards restructuring options.

ANDORRA

Law and Practice

Contributed by:
Miguel Cases and Laura Nieto
Cases & Lacambra

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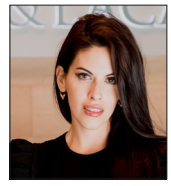
Cases & Lacambra is a client-focused international law firm with a cornerstone financial services practice, consisting of five partners, one senior associate and six associates. Key practice areas are banking and finance, capital markets, derivatives and structured finance. The firm's corporate and banking and finance group has extensive experience in all types of bilateral and syndicated, national and cross-border financing and debt-restructuring transactions, including structured finance, corporate and acquisition finance as well as project finance (real estate, energy and infrastructures) along with the structuring of scheme guarantees. The firm, with presence in Europe and America, has a significant track record in complex transactions involving the financial sector, special situations, financial markets regulation, cross-border disputes and particularly sensitive tax transactions. Cases & Lacambra offers expert legal advice, reconciling the concerns of all the parties involved and providing solutions that enable the execution of solid transactions for the benefit of its clients on both sides of the table.

Authors

Miguel Cases is a partner at and executive chairman of Cases & Lacambra and leader of the corporate law and financial services group. His practice includes the regulation of the financial sector, where he is an expert in the legal framework and regulatory environment applicable to entities subject to prudential supervision, especially those rendering financial and investment services. He is also an expert in investment arbitration procedure. Miguel has extensive experience advising credit institutions and investment services firms. He has also been a member of different working committees for the development of market standards in the International Swaps and Derivatives Association (ISDA).



Laura Nieto is a partner of Cases & Lacambra, and a member of the banking and finance practice in the firm's Andorran office. Laura specialises in banking and financial regulation and has extensive experience advising credit institutions and investment services firms in the legal framework and regulatory environment applicable to entities subject to prudential supervision, especially in the provision of financial and investment services. Her practice includes the pre-contracting, contracting and post-contracting of financial instruments and structured products, as well as global legal advice on netting market agreements and financial collateral arrangements. Laura's practice also includes cross-border transactions and funds distribution.

Cases & Lacambra

C/Manel Cerqueda i Escaler
3-5 AD700
Escaldes-Engordany
Principality of Andorra

Tel: +376 728001
Email: andorra@caseslacambra.com
Web: www.caseslacambra.com

CASES & LACAMBRA

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

The Principality of Andorra ("Andorra") is home to an important financial industry, which contributes decisively to the national economy. In turn, the financial industry is dominated by the banking sector, with a few key players (the three operating banking groups) that carry out banking and financial activities in the framework of a universal banking model offering a comprehensive range of services (focused on retail and private banking, asset management, and insurance services), which accounts for roughly 15% of the Andorran Gross Domestic Product (according to the most recent data published by the Andorran Banking Association). All their operations are regulated and supervised by the Andorran Financial Authority (AFA).

The proximity and interconnection between the Andorran financial and banking sector and the adjacent European countries, as well as the increasing trend observed in capital markets transactions carried out by local banking entities, determined the progressive implementation of relevant European banking and financial legislation since the entry into force of the Monetary Agreement with the European Union (EU). Pursuant to this Monetary Agreement, Andorra undertook to implement, from time to time, a substantial part of the EU financial legislative framework, as set forth in the Annex to such Monetary Agreement.

During 2023, decisive progress is expected to be made on the Association Agreement with the European Union, which will bring Andorra into the single market, including the financial sector.

According to the 2022 Annual Report of the Andorran Banking Association (*Associació de Bancs Andorrans*), the Andorran banking sector concluded the year 2022 with an aggregated profit of EUR113 million. Despite facing a year marked by notable acquisitions, including BancSabadell d'Andorra by MoraBanc and Vall Banc by Crèdit Andorrà, the banking industry managed to achieve a significant 16% growth in profits and a 4% increase in the volume of managed client resources, totalling EUR63.691 billion.

1.2 Impact of the Ukraine War

The impact of recent economic cycles and the process of regulatory convergence developed by Andorra have affected the direction and trends of its local market, albeit to a reduced extent compared with other neighbouring jurisdictions.

While the economic scenario of 2022 has been under significant tension due to increases in inflation and interest rates, and particularly the war in Ukraine, the measures taken have allowed for the stabilisation of economies and growth in most countries.

Act 5/2022, passed on 3 March, aims to provide legal coverage for the implementation of international sanctions on individuals, companies and states in Andorra. This Act allows for the blocking of accounts and financial transactions with local financial entities. It intends to serve as a framework for applying international sanctions from organisations such as the United Nations or the European Union. The sanctions can directly or indirectly impact the trade of goods, services, payments and capital, including blocking financial assets and various exchanges, such as scientific, technological, sports and cultural exchanges. The law applies to both individuals and legal entities, as well as states operating within Andorran territory.

1.3 The High-Yield Market

Andorran banks maintain a strong capitalisation of institutions with a CET1 (phase-in) solvency ratio of 15.76% at 31 December 2022, slightly below that of the previous year, which was 17%, and above the average for European banks, which stood at 15.3% according to EBA data from December 2022. This ratio was affected by the corporate operations that took place in the market.

It is worth noting that Andorra does not yet have any comprehensive capital markets legislation in place, that local banking entities are in a sound financial position and, as far as is known, that all capital markets transactions carried out in Andorra to date have reached – or exceeded – investment grade rating (BBB+ – Standard & Poor's and Fitch, or Baa2 – Moody's).

It remains to be seen whether the global (rising rate environment) and specific Andorran economic outlook (rated BBB+ by Standard & Poor's), coupled with the expected development of integral capital markets legislation, will lead to a further increase in local high-yield market activity.

1.4 Alternative Credit Providers

The Andorran loan market has not seen a significant growth in alternative credit providers, so its terms and structures have not been affected.

Please note that lending activity is a reserved activity in Andorra and, therefore, only financial entities (banking entities – *entitats bancàries* – and non-banking financial entities of specialised credit – *entitats financeres no bancàries de crèdit especialitzat*) that are authorised to do so by the local regulator (Andorran Financial Authority – *Autoritat Financera Andorrana*) can carry out lending activities, which encompasses:

- the granting of loans and credits, including, in particular, consumer credit and mortgage credit;
- factoring with or without recourse;
- the financing of commercial transactions (including forfeiting); and
- leasing and non-financial leasing (renting) with or without purchase options.

In conjunction with the small size of the Andorran loan market, this regulatory regime has traditionally raised scarce interest among local players in entering the local credit market. Nevertheless, there has been an increase in cross-border financing operations during recent years, which have funded the development of local projects

– usually on a syndicated basis, but also on a standalone basis – by granting financing to local banking entities.

On 1 December 2022, Act 42/2022, on digital economy, entrepreneurship, and innovation was approved, establishing the regulatory framework for crowdfunding platforms in Andorra.

1.5 Banking and Finance Techniques

Overall, the core credit investment activity is focused on financing the acquisition of real estate assets (normally the purchase of a first residence by Andorran residents) and commercial activity (credits and credit lines, among others).

However, in respect of banking and finance techniques, an upward trend can be seen, strengthening consumer financing; in particular, 2018 set the tone for the outset of capital markets transactions aimed at diversifying financing sources and extending the maturity of banking entities' passive balance sheets.

In connection with this, the first structured covered bonds issuance in Andorra was carried out during 2016 and 2017 as a transaction dually governed under English and Andorran law, with the first EUR100 million tranche rated above investment grade by Fitch Ratings (BBB+) and listed in the Irish Global Exchange Market (GEM).

It is reasonably likely that further capital markets transactions will take place from this year onwards, so as to allow local lenders to diversify their financing sources and in turn boost their real-economy financing capacity. Additionally, some business acceleration programmes for entrepreneurial projects in the consolidation and/or growth phase have been developed in Andorra. However, funding activities associated with these initiatives must only be carried out by licensed local entities.

In addition to traditional banking services, Andorra's financial landscape is witnessing the emergence of new techniques and financial instruments, including crowdfunding, DeFi, or token issuance. These developments have been facilitated and regulated by the Digital Assets Act and the Digital Economy Act. However, as at the time of writing, there are no entities in Andorra providing crowdfunding services. Nevertheless, these regulatory advancements demonstrate Andorra's proactive approach in fostering innovation and diversifying financing options for investors and borrowers in the financial market.

1.6 ESG/Sustainability-Linked Lending

Recent developments in our Andorra's banking sector show a growing focus on ESG or sustainability-linked lending. Andorran banks have taken significant steps to align their lending practices with sustainable objectives, offering sustainability-linked loans to businesses and individuals, encouraging borrowers to meet specific ESG targets and contribute to overall sustainability goals.

Furthermore, Andorran banks have incorporated ESG factors into their credit risk assessments, considering a borrower's environmental and social practices, reflecting their commitment to responsible and eco-friendly business practices. Additionally, the Andorran government has introduced regulations to support sustainability initiatives, providing tax incentives and favourable terms for loans tied to sustainable projects, fostering environmentally friendly investments.

Overall, these developments showcase a strong commitment from both the banking sector and the government to positively contribute to global

sustainability while promoting responsible economic growth.

2. Authorisation

2.1 Providing Financing to a Company

Under Andorran laws, the provision of financing to a company incorporated in Andorra is a reserved activity (lending) that can be carried out exclusively by specific financial entities (banking entities – *entitats bancàries* – and non-banking financial entities of specialised credit – *entitats financeres no bancàries de crèdit especialitzat*) that are authorised by the local regulator to do so (activity reservation regime).

Obtaining Authorisation

The administrative procedure to obtain prior authorisation to operate either as a banking entity or as a non-banking financial entity of specialised credit is set out in Act 35/2010, of 3 June, on the authorisation regime for the creation of new Andorran operating entities (*Llei 35/2010, del 3 de juny, de règim d'autorització per a la creació de noves entitats operatives del sistema financer andorrà*). Overall, this procedure encompasses the following phases.

Building a deposit

A non-remunerated deposit must be built before the AFA in the amount of EUR3 million for banking entities and EUR200,000 for non-banking financial entities of specialised credit (as proof of the applicant's solvency and the seriousness of the application), to be returned to the applicant within different timeframes upon the rejection or approval of the application.

Submitting an application

The submission of an application must be accompanied by specific documentation, including:

- the articles of association;
- a basic activity programme;
- exposition of the provision of activities pursuant to the promotion of the Andorran economy and the patronage of educational and cultural activities;
- an interim statement of the members of the first management body;
- an internal regulation of the conduct of the entity's members;
- means and plans detailing the manner in which the entity will comply with the applicable legislation – including information about the basic programme of activities for banking entities;
- a description of envisaged resources to comply with the organisational and functional requirements of the legislation and investor protection rules;
- a detailed description of activities to be outsourced;
- a generic description of measures envisaged to guarantee adequate internal control of procedures and to develop the activities in an adequate security environment;
- a description of the policies and procedures in relation to the legislation on the fight against money laundering and terrorist financing;
- the envisaged relations/bonds with other financial entities;
- the planned location for the registered office;
- a vision of personnel recruitment for the first three years of activity;
- a regulatory business plan, including the entity's constitution balance, balance sheets

and profit and loss accounts for the first three exercises;
- policies on the implementation of results;
- a description of the interim relationship of general direction members; and
- an affidavit of the person who will carry out the role of general director.

Incorporation

After the approval of the submission and the granting of prior authorisation by the AFA, there is a maximum period of three months in which to incorporate the banking entity or the non-banking financial entities of specialised credit in the form of a public limited company (*societat anònima*), and to provide the AFA with additional specific documentation – the incorporation deed referring to the availability of a minimum share capital of EUR5 million for banking entities and EUR2 million for non-banking financial entities of specialised credit, fully subscribed by cash contribution.

After Authorisation

The AFA would grant the definitive authorisation upon the submission of this documentation, which shall be published in the Official Gazette of the Principality of Andorra (*Butlletí Oficial del Principat d'Andorra*). In assessing the application for incorporating these financial entities, the AFA will assess the application according to the soundness of the project from a financial perspective and weighting, generally speaking, the contribution to the Andorran economy and, particularly, to its financial system (stability and investors' protection).

Other Organisational Requirements

In addition to obtaining prior authorisation as stated above, banking entities and non-banking financial entities of specialised credit must comply with the organisational requirements established by Act 7/2013, of 9 May, of the regime for the operational entities of the Andorran financial system and other provisions that govern financial activities in the Principality of Andorra (*Llei 7/2013, del 9 de maig, sobre el règim jurídic de les entitats operatives del sistema financer andorrà i altres disposicions que regulen l'exercici de les activitats financeres al Principat d'Andorra*), and Act 8/2013, of 9 May, which covers the organisational requirements and operating conditions of operating entities in the Andorran financial system, investor protection, market abuse and financial securities agreements (*Llei 8/2013, del 9 de maig, sobre els requisits organitzatius i les condicions de funcionament de les entitats operatives del sistema financer, la protecció de l'inversor, l'abús de mercat i els acords de garantia financera*). In summary, such requirements refer to the following:

- incorporation as a public limited company (*societat anònima*);
- designation of a specific corporate name (*entitat bancària* or *banc* for banking entities and *entitat financera – no bancària – de crèdit especialitzat* for non-banking financial entities of specialised credit);
- the location of the registered office within Andorra;
- determination of the specific company purpose;
- funding of minimum share capital;
- the composition of the board of directors (minimum of five members for banks and three for non-banking financial entities of specialised credit who fulfil suitability requirements, are of sufficient good repute, possess sufficient knowledge, skills and experience to perform their duties, and are able to act with honesty, integrity and independence of mind); and

- the composition of the general management (in particular, there is an incompatibility between the roles of the board of directors' president and the general director).

Solvency and liquidity

Banking entities and non-banking financial entities of specialised credit must also comply with the solvency and liquidity ratios (generic ratios of 8% and 100% respectively), and establish banking governance requirements (which are adapted to comply with requirements set out in CRDIV and the EBA and ECB Guidelines – EBA/GL/2017/12 and European Central Bank May 2018 Guide to fit and proper assessments) and internal controls regarding risk management, compliance and internal audit functions, conflict of interest policies, client assets and customer protection provisions, as well as the marketing regime.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Foreign lenders are restricted from granting loans directly to Andorran residents (natural or legal persons, such as a merchant or an individual), as lending activities carried out within Andorra qualify as reserved activities, the execution of which is subject to obtaining prior authorisation from the local regulator (activity reservation regime).

Nevertheless, due to the limited size of the Andorran financial market and its particularities (mainly, the absence of a lender of last resort), the local regulator has traditionally allowed a tolerated market practice that has garnered a consolidated track record in Andorra, under which foreign lenders are allowed to grant financing to local banking entities on a cross-border basis without breaching the activity reservation regime.

3.2 Restrictions on Foreign Lenders Receiving Security

The granting of security or guarantees by local entities to foreign lenders is not restricted or impeded in any manner. However, depending on the nature of the secured assets (real estate or company shares), foreign lenders may need to obtain prior foreign investment authorisation (*autorització d'inversió estrangera*) in accordance with the provisions of Act 10/2012, of 21 June, on Foreign Investment (*Llei 10/2012, del 21 de juny, d'inversió estrangera al Principat d'Andorra*) to enforce their claims against Andorran guarantors and take ownership over secured assets, after carrying out an enforcement proceeding within Andorra (before an Andorran court or following a notarial enforcement procedure) to acquire ownership over real estate assets in Andorra or more than a 10% stake in the relevant Andorran company.

3.3 Restrictions and Controls on Foreign Currency Exchange

The laws of Andorra do not provide for any restrictions, controls or other concerns regarding foreign currency exchange. Exchange rules therefore tolerate free transfer of funds denominated in a foreign currency from a local entity banking account to a foreign lender account held in any other country, for instance.

3.4 Restrictions on the Borrower's Use of Proceeds

There are no restrictions on the borrower's use of proceeds from loans or debt securities, although any requirements arising from anti-money laundering regulations under Act 14/2017, of 22 June, on fighting and preventing money laundering and terrorism financing (*Llei 14/2017, del 22*

de juny, de prevenció i lluita contra el blanqueig de diners o valors i el finançament del terrorisme) in concert with its implementing regulation(s) should be complied with by any Andorran financial entity (*entitat operativa del sistema financer*).

3.5 Agent and Trust Concepts

Andorra has not ratified the Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition. "Agent" and "trust" are not recognised concepts under Andorran laws, which expressly forbid the creation and use of trusts and other opaque structures preventing the identification of ultimate beneficiaries.

Alternative mechanisms to trust/agent structures are common in Andorra, with the most widely used being the designation of a local representative in Andorra, who is granted powers of attorney by the foreign lender to carry out the full range of securities-related actions (inter alia, taking legal actions and carrying out enforcement proceedings before Andorran courts and appropriation/seizing procedures over secured assets located in Andorra).

Moreover, recourse to parallel debt provisions (ie, a specific provision provided by the borrower recognising an additional debt in favour of the security agent appointed, independent from the debt owed by borrowers to the lender(s) with a reciprocally connected discharge statement) would be recognised under Andorran laws, as would a parallel debt security package.

3.6 Loan Transfer Mechanisms

The main loan transfer mechanisms available under Andorran laws are assignment, sale and novation.

Assignment

The assignment (*cessió*) of loans qualifies as a generic legal business conducted through diverse contractual transfer mechanisms, which provides the transfer over the totality or partiality of rights and obligations from the transferor (assignor) to the transferee (assignee). As a general rule, the assignment of loans does not require any particular mandatory formalities or requirements; however, in an assignment of mortgage loans (such as a transfer of a mortgage loans portfolio between local banking entities), the assignment of receivables shall be made by an agreement raised into the status of a public deed before a notary public.

Under Andorran laws, the notification of the assignment of loans is not mandatory, but it is recommended so as to prevent the exercise of the transferee's set-off right, which may be exercised against the amounts due to the transferor/assignor until the notification of such assignment is received. Under an assignment of loans, the specific security package set up (normally encompassing the incorporation of mortgage(s) and pledge(s)) may be transferred along with the loans by means of such assignment, although the exclusive transfer of specific loans is also permitted (this will normally be determined by the scope of the transaction and the nature of the mortgage loans).

Sale

The sale (*venda*) of loans (normally structured as performing or non-performing loans portfolios) is a specific legal business that determines the transfer of the full contractual position (rights and obligations) of the transferor (seller) to a transferee (purchaser) on specific loans (ie, the selling of all rights, benefits and obligations arising out of the loans sold). The sale of loans is commonly carried out through highly bespoke

sale and purchase agreements (SPA), which are adjusted to the specific characteristics and factors of the portfolio (composition, guarantees, portfolio quality, etc) and the contractual parties. The specific security package may also be transferred along with the loans by means of such assignment, although the exclusive transfer of specific loans is also permitted (again, depending on the scope of the transaction and the nature of the mortgage loans).

Novation

Contractual novation (*novació*) also performs the transfer of rights and obligations to the loans in an analogous manner as set out above, pursuant to the sale of loans; however, the novation mechanism encompasses two consecutive steps: first, the termination of the contractual relationship between the transferor and the transferee (borrower), and subsequently the creation of a new contractual relationship between the transferee and the borrower.

3.7 Debt Buy-Back

Debt buy-back transactions are not common in Andorra, with none taking place currently nor in recent years, as far as is known. Debt buy-back transactions directly carried out by a borrower or a sponsor would be permitted under Andorran laws as long as they are carried out in a manner that does not qualify as a financial activity.

3.8 Public Acquisition Finance

Under Andorran laws there are no specific legal rules or generic principles on "certain funds" provisions for mergers and acquisitions (private or public) or takeover transactions (as, for instance, in the manner set forth in the City Code on Takeovers and Mergers).

Please note that the absence of "certain funds" provisions under Andorran laws is a direct consequence of the fact that, under the bona fide principle coverage, parties must negotiate and enter into agreements following a duty of good faith. Therefore, if a party negotiates and enters into an agreement without the creditworthiness to fulfil its obligations arising out of or in connection with it, its counterparty would be entitled to make a claim for damages on the grounds of extra-contractual liability.

Notwithstanding the foregoing, specific "certain funds" provisions may validly be contractually provided by parties to a specific transaction to demonstrate certainty of funding (for example, as a bidding criterion in order to enter into a sale and purchase agreement) and full and unconditional funding disposal at the time of completion of the transaction. Specific penalties of different types (*clàusula penal*) may also be established between the parties.

3.9 Recent Legal and Commercial Developments

There have been no recent legal and commercial developments requiring changes to legal documentation. However, the Andorran banking sector has demonstrated a strong focus on technological investment, especially in digital transformation projects.

The country has taken significant strides to cultivate an environment conducive to digital innovation and financial activities. Notably, key legislative measures have been approved, such as Act 24/2022, of 30 June 2022, on the digital representation of assets, cryptography, and the application of DLT/blockchain technology (the "Digital Assets Act"), which pertains to digital representation, cryptography, and blockchain technology, and the Act 42/2022, of 1 December, on digital economy, entrepreneurship, and innovation (the "Digital Economy Act").

These legislative advancements underscore Andorra's commitment to embracing technological progress and fostering opportunities for growth and innovation within its financial sector.

3.10 Usury Laws

There are no specific laws or regulations limiting the amount of interest that can be charged. However, the Andorran Superior Court (*Tribunal Superior de Justícia d'Andorra*) has recognised usury in several resolutions based on the interest regulated by the Andorran Banking Association (*Associació de Bancs Andorrans*).

3.11 Disclosure Requirements

In Andorra, there are no specific rules and/or laws regarding the disclosure of certain financial contracts.

4. Tax

4.1 Withholding Tax

If the lender is a natural person, the amounts paid to the lender by a legal person who is a tax resident in Andorra are subject to withholding tax, at a rate of 10%.

4.2 Other Taxes, Duties, Charges or Tax Considerations

The payments collected as interest by a legal entity will be included in the tax base for the calculation of the Corporate Income Tax (*Impost de Societats*).

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Tax concerns are based on an eventual existence of a permanent establishment. It is relevant to ascertain if there is a Double Taxation Agreement between Andorra and the foreign country. If not, Andorran rules and regulations will apply. Under the Andorran definition of a permanent establishment, the threshold of activity of a company in one territory that may result in the existence of a permanent establishment is determined by the following criteria: a fixed place of business or a dependent agent. This particular issue may be mitigated considering the boundaries of the permanent establishment regime.

5. Guarantees and Security

5.1 Assets and Forms of Security

The assets typically available as collateral to foreign lenders are as follows:

- first or second-ranking mortgage(s) over a borrower's real estate assets;
- pledge(s) over the shares of the borrower's subsidiaries;
- pledge(s) on the borrower's bank accounts (over both the bank account balance and the banking account), normally along with periodical cash-sweeps and ad hoc limitations – eg, cap-alike limitations (maximum-free disposal amounts) or floor-alike limitations (minimum-unavailable amounts and disposals);
- pledge(s) granted over credit rights deriving from any income-producing agreements entered into by the borrower (eg, insurance policies, O&M agreements or hedging agreements that generate periodic, liquid, due and payable credit rights to the borrower); and
- in certain cases, pledge(s) over specific assets of the borrower (eg, highly specialised or heavy machinery).

Creation of Security Interests

Under Andorran laws, the creation of security interests does not require notarisation (unless effect against third parties is sought), except in the case of mortgages, where constitution

before a public notary followed by registration acts as a validity condition. However, as a matter of best practice, notarisation is advisable, in order to increase effectiveness against third parties. On the other hand, decisions authorising the creation of a valid security over specific asset(s) must be adopted in accordance with the generic legal and statutory requirements applicable to the pledger/company; specifically, in a pledge over company shares, the registration of such security interest in the Registry Book of Shareholders (*Llibre Registre de Socis*) is required.

It is worth noting that securities in Andorra – as opposed to other neighbouring jurisdictions – only grant creditors a preferential position to receive their credit from a specific debtor's asset in respect of other ordinary creditors in an insolvency scenario.

Upon notarisation of the mortgage or security interest, registration usually takes one or two weeks.

Costs

In terms of the costs involved, the notary public applies the corresponding fee depending on the value of the secured liability. Those fees were published by means of the Decree 17 June 2020, and the specific amount varies in accordance with the specific nature and economic interest of the transaction.

5.2 Floating Charges and/or Similar Security Interests

Due to the rigid principle of specialisation and determination imposed by Andorran laws, creating guarantees for a multiplicity of obligations through a floating charge – as configured by Common law – is not permitted.

Nevertheless, Andorran laws tolerate the creation of a pledge (*penyora*) over future credit rights of the borrower. Moreover, the legal regime established by Act 8/2013, of 9 May, which covers the organisational requirements and operating conditions of operating entities in the Andorran financial system, investor protection, market abuse and financial securities agreements (*Llei 8/2013, del 9 de maig, sobre els requisits organitzatius i les condicions de funcionament de les entitats operatives del sistema financer, la protecció de l'inversor, l'abús de mercat i els acords de garantia financera*), enables the creation of security financial collateral arrangements that guarantee relevant financial obligations consisting of or including – totally or partially – present or future, actual or contingent or prospective obligations, as well as obligations of a specified class or kind arising from time to time.

Alternative options for replicating the effects of a floating charge under Andorran laws – especially in syndicated lending scenarios – are the creation of different pledges over the pledged asset to the benefit of different lenders, assigning a percentage to each guaranteed obligation with joint execution agreed upon an intercreditor agreement (with the same or different ranks), or the creation of concurrent pledges (ranking pari passu), with regulation of the distribution of the amount obtained upon enforcement between creditors.

5.3 Downstream, Upstream and Cross-Stream Guarantees

Andorran law tolerates the creation of downstream, upstream and cross-stream guarantees. While no express legal restrictions apply to downstream guarantees, the provision of upstream guarantees may incur the risk of appreciating fraudulent conveyance (*acció pauliana*) in an insolvency scenario, in which, for instance,

the lender grants financing to a parent company that merely holds the shares of a subsidiary company as an asset.

In this connection, if successfully proved before an Andorran court, the lender would be exposed to the exercise of the claw-back regime foreseen by Decree dated 4 October 1969 (*Decret en relació a la cessació de pagaments i fallides, del 4 d'octubre de 1969*) in the scenario of the originator's insolvency declaration (*cessació de pagaments*), which would determine that the provision of the upstream guarantee is set aside, unless the existence of some consideration in favour of the guarantor/subsidiary can be proved (ie, as the subsidiary guaranteeing debt holds no shares in the parent company borrowing the funds, the subsidiary/guarantor does not directly receive any benefits from the financing and, thus, the risk of the provision of the upstream guarantee generates obligations upon the subsidiary/guarantor that largely exceed those of the mother company borrowing financing, or even qualifies as a gratuitous act).

See **7.5 Risk Areas for Lenders**.

5.4 Restrictions on the Target

In a target acquisition scenario, the target – incorporated as a public limited company (*societat anònima*) or as a private limited company (*societat limitada*) – is restricted from granting financial assistance for the acquisition of its own shares in accordance with financial assistance rules provided for by capital companies' regulations. Unlike the legal regime of adjacent jurisdictions, financial assistance rules foreseen by Act 20/2007, of 18 October, on Public Limited Companies and Private Limited Companies (*Text refós de la Llei 20/2007, del 18 d'octubre, de societats anònimes i de responsabilitat limitada*) limit the granting of assistance over the target's shares to a maximum generic percentage of 10%. In this respect, it is mandatory to make an accounting reserve on the liabilities balance sheet of the target that is equivalent to the value of the shares accepted as guarantee.

These restrictions do not affect Andorran financial entities entering into crediting transactions with third parties.

5.5 Other Restrictions

There are no other particular restrictions, nor significant costs associated with the granting of securities or guarantees under Andorran laws, but it is worth noting that the creation of guarantees over public domain assets (*béns públics/béns patrimonials*) is legally restricted.

When security is taken over financial instruments, recourse to financial collateral security arrangements is advisable, so this sort of guarantee is expressly regulated in Act 8/2013 of 9 May 2013 on the organisational requirements and operating conditions of entities operating in the Andorra financial system, investor protection, market abuse and financial securities agreements (*Llei 8/2013, del 9 de maig sobre els requisits organitzatius i les condicions de funcionament de les entitats operatives del sistema financer, la protecció de l'inversor, l'abús de mercat i els accords de garantia financera*) – in conjunction with Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements, whose implementation into the Andorran legal framework was completed in March 2019 – and gives heightened protection for lenders.

5.6 Release of Typical Forms of Security

Overall, the typical forms of security are released upon the payment or cancellation of their secured obligations, yet parties to the specific financing/

loan agreements and security packages normally agree to carry out further formalities on this release procedure on a case-by-case basis.

In a release of possessory pledges, the return of possession of the pledged asset to the borrower/pledger is required. For non-possessory pledges (*penyora sense desplaçament*) and pledges over banking accounts or financial instruments, specific formalities may replace the return of possession over the asset to the borrower/pledger.

5.7 Rules Governing the Priority of Competing Security Interests

Due to the absence of a Land Registry in Andorra, priority in mortgages is ranked by means of recording the granting of a public mortgage deed in the Andorran Notary Chamber (*Cambra de Notaris del Principat d'Andorra*) – ie, the date of constitution of the mortgage.

In terms of possessory and non-possessory pledges, priority is determined by their perfection and the transfer of possession.

Contractual subordination is commonly used in Andorra (eg, the subordination of junior debt by agreement between the senior creditor and junior creditor). The subordination of a secured mortgage to a newly created one requires an express agreement between creditors and the raising of such consent into the status of a public deed before a public notary. In the subordination of a pledge, express agreement between the parties is required, and its documentation through a notarial deed is recommended.

Due to the absence of an express provision in the insolvency legislation, contractual subordination should prevail as long as the pars condition creditorum principle is respected, as estimated by the insolvency judge (*batlle*).

5.8 Priming Liens

In Andorra, there are no security interests that arise by operation of law that can prime a lender's security interest. No specific security interest automatically takes priority over a lender's existing security interest. Consequently, lenders are not at risk of their security interests being superseded by other claims based on legal provisions.

To secure transactions, parties commonly use standard guarantees as pledges or mortgages in their agreements. Lenders may seek additional collateral or guarantees to further strengthen their position.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

A secured lender will be able to enforce the collateral granted by a borrower as guarantee in accordance with the contractual provisions established by the specific loan and security contractual package entered into between them.

For financing transactions, a typical security package structure would cover the following types of guarantee:

- mortgage(s) (if the target is a real estate asset);
- pledge(s) over the shares of a special purpose vehicle (SPV), if applicable. Normally the SPV will be incorporated using the form of a private limited company set up under Andorra laws;
- pledge(s) over any SPV's bank accounts held with local banking entities on the company's bank accounts (usually with periodical cash-sweeps); and

- more commonly in project financing transactions, pledges over credit rights arising from all sorts of cash flow-generating asset(s) and agreement(s) would be granted (eg, insurance and hedging agreements).

The creditor shall notify the counterpart of each pledged agreement in an enforcement scenario in order to receive any payments due or positive balanced set-off rights deriving from the pledged credit rights.

Creation of Mortgages

The creation of mortgages requires the intervention of a notary public and the granting of a public deed (ie, mortgage loan) followed by subsequent registration (by means of a margin note made by the public notary) before the Chamber of Notaries of the Principality of Andorra (*Cambra de Notaris del Principat d'Andorra*) as a condition of validity for the mortgage. This body acts as a centralised land register for public deeds granted by Andorra public notaries. The creation of pledges does not require the intervention of a public notary, unless such pledge must have legal effects against third parties.

Enforcement of Loans and Guarantees

In connection with the enforcement of loans and guarantees, it is worth noting that, under the current state of the law, there is no direct foreclosure enforcement procedure under Andorran procedural rules, so it is necessary to carry out a declarative civil proceeding as a prior step for the enforcement of a claim. A notarial enforcement proceeding is also available upon the parties' commitment.

6.2 Foreign Law and Jurisdiction

The choice of a foreign law as the governing law of a loan or security agreement, the submission to a foreign jurisdiction and a waiver of immunity will be valid and binding under the laws of Andorra and, consequently, will be upheld in connection with a claim presented by a foreign lender before Andorran courts.

The choice of a foreign law will be upheld by Andorran courts if the content and validity of the relevant provisions of the chosen laws may be duly proved without contravention of the Andorran Constitution or Andorran principles of public order.

If a specific submission clause is agreed by the parties to a loan or security agreement, it must comply with the following requirements in order to be sustained before the Andorran courts:

- it must govern an international situation;
- it must refer to a state legal framework; and
- there must be an express election of a specific law that is expressly and universally agreed by the parties to the relevant agreement.

Upon verification of these requirements, Andorran courts should decline their competence in favour of the courts of the elected jurisdiction.

6.3 Foreign Court Judgments

The enforcement of a judgment given by a foreign court against an entity located in Andorra is subject to confirmation by the Courts of First Instance through a previous exequatur procedure.

Proceedings for exequatur are brought by the party that is interested in the enforcement of the foreign judgment (ie, the foreign lender). This procedure is subject to claim and counterclaim, and is participated in by the Public Prosecutor (*Ministeri Fiscal*) and the party against whom the enforcement is sought. The approval of the exequatur entails verification by the Courts of First

Instance of the following requirements pursuant to the foreign judgment:

- the competence of the court that has given the ruling;
- the regular nature of the foreign procedure, including the right to jurisdiction (under the Andorran Constitution);
- the application of the competent law in compliance with Andorran conflict rules;
- conformity with national and international public order; and
- the absence of any fraud from an Andorran legal standpoint.

Pursuant to the enforcement of an arbitral award (*laude*) against an entity located within Andorra, the starting point is the condition of Andorra as a State Party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, of 10 June 1958, which entered into force in Andorra in September 2015. Therefore, arbitral awards are recognised as directly enforceable instruments before Andorran courts without a retrial of the merits of the case.

6.4 A Foreign Lender's Ability to Enforce Its Rights

The key issue affecting a foreign lender's ability to enforce its rights under a loan or security agreement is the absence of a direct foreclosure procedure under Andorran procedural rules (see **6.1 Enforcement of Collateral by Secured Lenders**).

Furthermore, please note that the appropriation of secured assets by a foreign lender upon carrying out enforcement procedures may trigger foreign investment authorisation requirements.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

Insolvency

Due to the small size of the Andorran industrial and commercial sector, viable pathways for company rescue or reorganisation procedures out of insolvency proceedings are limited. Specifically, the practice of company aid in Andorra is focused on entering into refinancing agreements with local banking entities or receiving financial support from a parent or subsidiary within group structures.

7.2 Waterfall of Payments

It was not until May 2021 that the Andorran insolvency regulations provided for a specific order of priority of claims in an insolvency scenario.

Traditionally, the insolvency rules and Andorran case law made a distinction between special privileges (*privilegis especials*) and general privileges (*privilegis generals*) over movable assets (*béns mobles*) and real estate assets (*béns immobles*). In this light, creditors were paid in the following order:

- creditors granted a special privilege over movable assets (pledges along with bonds and certain specific privileges, such as those afforded to the sellers of movable assets);
- creditors granted a special privilege over real estate assets (mortgages and concrete privileges, such as those in favour of architects, real estate asset sellers and real estate asset acquirers to recover the price paid plus legal interests in the resolution of the sale agreement);
- creditors granted a general privilege (such as the privilege provided to workers for their salary amounts); and

- the rest of the creditors, pro rata of their respective credits upon verification and admission by the insolvency administration.

In the case of special privileges (ie, claims secured by means of mortgages, pledges, bonds or any other special privilege over movable or real estate assets), creditors were favoured with a segregated enforcement right, which allowed the enforcement of the specific guarantee on the creditor's own benefit regardless of the development of the insolvency proceeding(s).

Notwithstanding the foregoing, with the entry into force of the aforementioned Act 7/2021, of 29 April, on the recovery and resolution of banking institutions and investment companies, a proper order of credit priority has been introduced. Such an order is as follows.

- Special privilege credits are considered those of the Andorran Deposit Guarantee Fund (*Fagadi*) and the Andorran Investment Guarantee System (SAGI) and the part of eligible deposits of individuals and any natural or legal person that employs less than five people and has an annual volume of activity or with an annual balance up to EUR300,000 exceeding the level of coverage provided for in Law 20/2018, of 13 September, regulating the Andorran Deposit Guarantee Fund and the Andorran Investment Guarantee System.
- Preferential ordinary credits are those resulting from debt instruments that do not meet the following conditions:
  (a) that they have been issued or created with an effective maturity term equal to or greater than one year;
  (b) that they are not derivative financial instruments nor have implicit derivative financial instruments; and
  (c) that the terms and conditions and, if applicable, the issuance prospectus include a clause establishing that they have a lower insolvency preference than the rest of the ordinary credits and, therefore, the credits derived from these debt instruments must be satisfied after the remaining ordinary credits.
- Subordinate credits are those that, as opposed to ordinary credits, have been subordinated with the rest of the credits against the debtor by means of a contractual agreement or a legal provision. These shall follow the following order of preference:
  (a) the principal amount of the subordinated debt (other than additional tier 1 capital or tier 2 capital);
  (b) the principal amount of the remaining securities, instruments or contracts that have been taken into consideration for the purpose of calculating the minimum equity (tier 2 capital); and
  (c) the principal amount of the financial instruments constituted by mandatorily convertible debt securities, in both cases when they are computable for the purposes of calculating the minimum equity (additional tier 1 capital).

7.3 Length of Insolvency Process and Recoveries

Under the Insolvency Decree dated 4 October 1969 (*Decret en relació a la cessació de pagaments i fallides, del 4 d'octubre de 1969*), the commencement of insolvency proceedings does not generally have an impact on a lender's rights to enforce its loan or any security or guarantee, as long as its claims are guaranteed by means of a security – ie, mortgage, pledge (either ordinary as possessory or non-possessory nature of financial collateral arrangement), bonds or special privileges as provided for in insolvency rules – and up to the value of such specific guar-

antee or security (ie, any amount of the claim exceeding the value of the guarantee will bear the nature of an ordinary claim).

There are specific timeframes for enacting the enforcement of a mortgage securing claims (two months from the date of the cessation of payments) by the creditor. For claims secured by way of pledges, the enforcement is not subject to any specific term and may be immediately exercised by the creditor.

Pursuant to the specific restructuring and resolution regime regulated by Act 7/2021, of 29 April, on the recovery and resolution of banking institutions and investment companies (*Llei 7/2021, del 29 d'abril, de recuperació i de resolució d'entitats bancàries i d'empreses d'inversió*), which completely implements Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms, the Andorran State Resolution Agency for Banking Entities (*Agència Estatal de Resolució d'Entitats Bancàries* – AREB) is granted powers to stay certain contractual rights through the issuance of an administrative act (namely, any payment or delivery obligation arising from any agreement entered into by the affected banking entity) for a maximum period extended from the date on which the exercise of such stay right is published until midnight on the following business day.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Due to the small size of the Andorran industrial and commercial sector, viable pathways for company rescue or reorganisation procedures out of insolvency proceedings are limited. Specifically, the practice of company aid in Andorra is focused on entering into refinancing agreements with local banking entities or receiving financial support from a parent or subsidiary within group structures.

7.5 Risk Areas for Lenders

The main risk areas for lenders upon the insolvency of the borrower, the security provider or the guarantor relate mainly to the enforcement of the financing contractual set and the guarantees provided by the security provider and the guarantor. Claw-back risk must also be monitored. Under the claw-back regime stated in the Insolvency Decree, the Andorran competent judge (*batlle*) is entitled to set aside any transactions of any nature that are carried out by the borrower within the 24 months prior to the initiation of its insolvency procedure and are considered to be prejudicial to the borrower's insolvency estate, and that fall into any of the following categories:

- transactions carried out through agreements where the borrower's obligations largely exceed those of its counterparty;
- if the total prepayments of non-matured debts are verified;
- all mortgages or guarantees granted over assets of the borrower after the cessation of payments date for securing pre-existing debts of the insolvent entity; or
- gratuitous acts done a maximum of six months prior to the date of cessation of payments as declared by the Andorran judge.

Additionally, it is crucial to set forth the election of the nature of the foreclosure/enforcement procedures and the setting up of a comprehensive security package.

8. Project Finance

8.1 Recent Project Finance Activity

Project financing has been a rising trend in the Andorran financial market in recent years. Moreover, this trend is likely to continue, fostered by synergy between the public and private sector.

Public Sector Initiatives

In public sector initiatives, the mainstream of projects is due to Andorra's commitment to shift its economy towards a sustainable energy model based on the predominance of renewable energies, which enables a reduction in foreign energy dependence (a characteristic trait of the Andorran balance of payments) upon investment in renewable energy-generating instruments, projects and premises. The development of road and other transport infrastructure (for instance, a heliport and – potentially – an airport) is also expected, and will be accompanied by privately led projects for the development of tourism premises and real estate promotion transactions.

Major Milestones

The main milestones in project finance have included road infrastructure projects such as *Túnel dels Dos Valires* (EUR159 million) and *Túnel de la Tapia* (EUR42 million), and energy premises – the first liquefied natural gas-powered cogeneration plant is in Soldeu, with further premises to be constructed during the coming years). This lift off of the Andorran project finance market must be considered in connection with Act 21/2018, of 13 September, on the impulse to energy transition and climatic change (*Llei 21/2018, del 13 de setembre, d'impuls de la transició energètica i del canvi climàtic*), which reasonably prepares the ground for further renewable energy projects (including the creation of an Andorran CO_2 emissions market) to achieve the climatic goals outlined in the Kyoto Protocol and the Paris Agreement of 30 November 2016. Moreover, a White Energy Book (*Llibre Blanc de l'Energia d'Andorra*) has also been issued, following this trend.

Legal Framework

The legal framework of project financing is composed of different regulations, whose basis is grounded in the financial regime regulating the following:

- the provision of financial activities in Andorra (mainly Act 7/2013, of 9 May, on the regime for the operational entities of the Andorran financial system and other provisions that govern financial activities in the Principality of Andorra, and Act 8/2013, of 9 May, which covers the organisational requirements and operating conditions of operating entities in the Andorran financial system, investor protection, market abuse and financial securities agreements);
- the foreign investment regime (Act 10/2012, of 21 June, on Foreign Investment);
- bankruptcy proceedings (Decree dated 4 October 1969);
- capital companies (Act 20/2007, of 18 October, on Public Limited Companies and Private Limited Companies);
- crowdfunding, DeFi and other alternative financing forms through the Digital Assets Act and the Digital Economy Act, promoting innovation and regulating digital representation of assets through the use of cryptography and distributed ledger and blockchain technology;
- the legal regime on guarantees (governing their creation, life cycle and enforcement, deriving from Andorran civil rules); and
- procedural rules (civil procedural rules – Act 22/2021, of 17 September, Code of civil procedure, notarial legislation and arbitration regulations – Act 13/2018, of 31 May, on the

creation of the Andorran Arbitration Court and Act 47/2014, of 18 December, on Arbitration).

8.2 Public-Private Partnership Transactions

Public-private partnership transactions are in their infancy, with none materialising so far; however, it is reasonable to expect a stable stream of collaboration between the public and private sectors in the coming years, especially for renewable energies projects.

The key piece of legislation is the Public Contracts Act dated 12 May 2022 (*Llei de contractació pública*), whose main trait is the imposition of the following specific requirements on foreign contractors (*contractistes estrangers*):

- verification of their legal capacity and good standing before their home country courts;
- EU contractors can engage in public sector contracts if they are authorised to provide the contracted service in their home country;
- EU national entrepreneurs must prove financial stability and, if needed, qualifications for the contract;
- in certain contracts, contractors must be properly classified in Andorra, and the tender documents may require the establishment of a permanent establishment in Andorra;
- express submission to the Andorran courts related to bidding for, and execution of, the contract;
- bearing translation costs in front of a public administration;
- issuing tenders, preferably in euros;
- for construction contracts, an authorisation for temporary establishment must be requested and maintained during the whole execution of the contract; and
- for public service management contracts, an Andorran shares company must be incorporated and operate for the concession period.

Third-country contractors are subject to the principle of reciprocity, by means of which non-EU contractors must demonstrate reciprocity by allowing Andorran firms access to similar contracts in their respective countries.

8.3 Governing Law

Andorra is not a part and is not a member state of the European Union nor of the European Economic Area and, consequently, is not subject to Regulation (EC) No 593/2008, of 17 June 2008, of the Parliament and the Council on the law applicable to contractual obligations (Rome I) nor to 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). Instead, conflict rules are based on case law with the consequent risk of change by the court's judgments.

However, it seems reasonable, and in accordance with some Andorran case law, that Rome I could apply in case of lack of provisions of Andorran law and as a principle of interpretation. In this light, a choice of law provision must comply with the following requirements in order to be upheld by the corresponding competent court, according to Rome I: (i) it must govern an international situation, (ii) it must refer to a state legal framework; and (iii) there must be an express election of the specific law expressly and univocally agreed by the parties to the relevant agreement. Therefore, the election by the parties to an agreement of a foreign law as the substantive law to govern such agreement is a valid and legally binding choice of law if such

choice complies with the requirements mentioned above.

8.4 Foreign Ownership

As of the date of writing, there are no restrictions in Andorra on the ability of foreign entities owning or otherwise having real property (surface or subsurface) or water rights relating to the project or of foreign lenders holding or exercising remedial rights on liens on any such property.

8.5 Structuring Deals

The key issues for setting up and executing project financing transactions in Andorra include the following.

- Structuring the deal firmly, covering risk aspects arising from the cross-border nature of the transaction – eg, the creation of a comprehensive security package, prior analysis of the legal and regulatory regime (especially on foreign investment authorisation), establishing contacts with the relevant administration and analysing and adequately assessing the borrower (legal opinions, representation powers, etc), and stating the financing instrument used (eg, loan or credit).
- Determining the legal form of the project company used as an SPV (normally incorporated as a private limited company – *societat limitada*) and the capital stake that will be held by the foreign entity.
- Having a clear picture of the applicable regulations to the project, particularly regarding the enforcement instruments and procedures.

8.6 Common Financing Sources and Typical Structures

Typical sources for funding project financing include recourse to club deals (composed of local and foreign lenders) and the incorporation of an Andorran SPV. Banking financing is predominant in this sort of transaction, while recourse to export credit agency financing or project bonds is not frequently seen, mainly due to the absence of any capital markets legislation in Andorra.

However, due to the legislative framework and political climate, the issuance of project or green bonds to fund project finance transactions is emerging as an interesting perspective, particularly when other bond issuances have taken place recently.

8.7 Natural Resources

Overall, the main issues associated with the acquisition and export of natural resources in Andorra relate to the regulatory and administrative authorisations. Please note that Andorra payment balances present an energy deficit, mainly due to the lack of fossil resources and electricity, which are imported mainly from France and Spain.

In light of this, the export and import of electrical energy is exclusively reserved to the public company FEDA (*Forces Elèctriques d'Andorra*) as a direct management regime, as is the distribution of electrical energy (wholesale and retail distribution) in accordance with Act 5-2016, of 10 March, regulating FEDA and the electric sector regime (*Llei 5-2016, del 10 de març, que regula l'ens públic Forces Elèctriques d'Andorra (FEDA) i el règim de les activitats dels sectors elèctric, del fred i de la calor*).

However, cogeneration activities have been regulated and are subject to a liberalised legal regime, which permits the indirect management thereof (administrative concession regime).

8.8 Environmental, Health and Safety Laws

The main health, environmental and safety laws applicable to projects are the General Act on territorial planning and urbanism dated 29 December 2000 (*Llei general d'ordenació del territori i urbanisme, de 29-12-2000*), the Construction Regulation dated 3 October 2010 (*Reglament de Construcció, del 3-10-2012*), the Act on security and industrial quality dated 22 June 2000 (*Llei de seguretat i qualitat industrial, de 22-6-2000*) and the Energetic Regulation on edification (*Decret de l'1 d'octubre del 2010, d'aprovació del Reglament energètic en l'edificació*).

AUSTRIA

Law and Practice

Contributed by:
Markus Fellner, Veronika Seronova and Mario Burger
Fellner Wratzfeld & Partner Rechtsanwälte GmbH

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Fellner Wratzfeld & Partner Rechtsanwälte GmbH (fwp) has a team of more than 120 highly qualified legal personnel. The firm's major fields of specialisation include banking and finance, corporate/M&A, real estate, infrastructure and procurement law, changes of legal form, reorganisation and restructuring. fwp advises renowned credit institutions and financial services providers on financing projects, representing mainly Austrian and international private companies, but also has clients from the public sector. The firm's expertise has proven its worth repeatedly, not only in connection with project and acquisition financing, but also in regard to financing company reorganisations; fwp is also able to draw upon substantial experience gained in the financing of complex consortia in the last few years.

Authors

Markus Fellner was admitted to the Austrian Bar in 1998 and has been a partner at Fellner Wratzfeld & Partners since 1999, now heading the firm's banking and finance practice group. He specialises in banking and finance, insolvency law and restructuring, corporate/M&A, and dispute resolution. Markus has published a considerable number of articles and essays on topics related to these areas of expertise, including capital maintenance rules in Austria, M&A, and business restructuring and insolvency. He speaks German, English and Italian.

Veronika Seronova was admitted to the Austrian Bar in 2016, and has been an attorney at law with Fellner Wratzfeld & Partners since then. She has particular experience and knowledge in the areas of banking and finance, labour law, and dispute resolution. Veronika speaks German, English, Slovak and Czech.

Mario Burger has been an associate with Fellner Wratzfeld & Partners since 2020. He has particular experience and knowledge in the areas of banking and finance and corporate/M&A. Mario speaks German and English.

Contributed by: Markus Fellner, Veronika Seronova and Mario Burger,
Fellner Wratzfeld & Partner Rechtsanwälte GmbH

Fellner Wratzfeld & Partner Rechtsanwälte GmbH

Schottenring 12
A-1010
Vienna
Austria

Tel: +43 1 53770 0
Fax: +43 1 53770 70
Email: office@fwp.at
Web: www.fwp.at

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

As everywhere in Europe, the regulatory framework (in particular, the determination of risk-weighted assets and of own funds) has had a significant impact on overall strategy in the banking sector, which increasingly aims at deleveraging banks' balance sheets (in particular, by way of disposal of non-core assets).

1.2 Impact of the Ukraine War

Fuelled by increasingly expensive energy in the wake of the Ukraine war, consumer prices in the European Union recently rose significantly. The European Central Bank (ECB) is thus falling well short of its inflation target, which is aiming for 2% as the optimum value for the economy. Record inflation in the Euro area is forcing the ECB to act. Thus, in July 2022, the ECB abandoned its zero interest rate policy and increased the key interest rate to the current level of 4.25%.

The ECB decision has had far-reaching consequences for borrowers. The time of cheap loans is over, and loans have become more expensive again. Domestic banks have already been raising interest rates for some time, and a further increase is expected.

Furthermore, on 1 August 2022, stricter criteria for granting private real estate loans came into force. Under the new rules, buyers in the future will have to provide evidence of 20% of the purchase price in the form of equity, the monthly loan instalment may not exceed 40% of the monthly net disposable household income, and the term of the financing may not exceed 35 years. The measures are set to prevent potentially difficult situations on the real estate market. According to the Austrian National Bank, however, Austria is not on the verge of a real estate bubble bursting. The domestic real estate market is still considered stable. However, the momentum of rising prices and the possibility of systemic risk are intended to be curbed by these legal steps.

1.3 The High-Yield Market

The Austrian marketplace (Vienna Stock Exchange) has not developed a high yield market as active as those in other jurisdictions.

Predominantly, new issues of bonds admitted to trading on the Vienna Stock Exchange comprise issuance programmes of credit institutions.

There is also a limited number of mid-cap issuers and numerous foreign issuers, largely aiming at admission of their instruments to the (non-regulated) multilateral trading facility (Vienna MTF), which does not require the approval and publication of a prospectus in line with the Prospectus Regulation.

There is, nevertheless, a solid share of classic corporate bonds which are largely issued by listed blue chip companies, which do not constitute a true alternative to bank loans for the larger market.

1.4 Alternative Credit Providers

Traditionally, the Austrian lending market has been dominated by credit institutions licensed in Austria. Alternative credit providers such as insurance companies are not regularly seen as original lenders in transactions, but rather rely on acquiring existing exposure from credit institutions which handle the origination.

Austria is a strongly regulated banking market where a banking licence is required both for commercial lending as well as the commercial acquisition of receivables (factoring). The latter will only be fully exempted from the licence requirement if, and to the extent effected for, the purpose of that acquisition is securitisation to special purpose securitisation vehicles (ie, companies specialising in acquiring loan exposure and transferring it to their financing providers, frequently in the form of bond issues).

Limited exceptions apply in the context of small-category financings, such as crowdfunding. In addition, the Austrian regulator (*Finanzmarktaufsicht* or FMA) has developed a practice according to which the offering of certain very limited alternative structures to classic loan agreements (subordinated loans, sale and lease-back structures, etc) does not require a banking licence.

Non-bank Lenders

Other than that, Austrian banking legislation will (with only a few exceptions, for example, where applicable with regards to banking secrecy) not apply to certain companies rendering banking services if and to the extent that these pertain to their original and permitted operations; these include insurance companies, pension funds, non-profit organisations, societies, certain non-EU securities firms as well as alternative investment funds.

In market practice, these exceptions have not led to significant competition for banks. Rather, in specific areas (eg, where insurance companies wish to act as lenders for investment purposes), credit institutions are involved for purposes of origination and pass-on loan portfolios.

1.5 Banking and Finance Techniques

In terms of banking and finance techniques, Austrian borrowers rely primarily on local banks (to a significant degree on their respective "house bank") for their financing. In those cases, the complexity of the loan and security documentation as well as reporting obligations and (financial) governance are fairly limited (and frequently rely on in-house standard documentation).

In addition, the Austrian lending market has seen an influx of both foreign lenders and Austrian banks seeking to provide financing as a syndicate in a club deal, or aiming at syndication of their relevant loans to international banks; in those scenarios, significantly more complex and voluminous loan documentation (based on the standards made available by the Loan Market Association adapted for Austrian needs) has become more common.

1.6 ESG/Sustainability-Linked Lending

Internationally, in the EU and in Austria, the fight against climate change began several years ago. The result so far has been a multi-layered, constantly amended legal structure of agreements and commitments under international law (primarily the Kyoto Protocol and the Paris Agreement), requirements under EU law and national laws.

The EU has decided to restructure the entire financial system to further sustainable finance.

The term "sustainable finance" usually refers to the consideration of environmental and social issues (so-called ESG factors) in investment decisions, leading to more investment in long-term, sustainable activities.

In this context, four core regulations are to be observed.

- Under Regulation (EU) No 573/2013 (Capital Requirements Regulation (CRR)), large institutions that have issued securities admitted to trading on a regulated market of an EU member state are required to disclose information on sustainability risks from mid-2022. In addition, far-reaching requirements for the inclusion of sustainability risks in the risk management and supervision of institutions have already come into force.
- Regulation (EU) 2019/2088 (Disclosure Regulation) obliges financial market participants to disclose, on the one hand, their concepts for integrating sustainability risks into their investment decision-making process and, on the other hand, the adverse effects of investment decisions on certain sustainability factors. These extended information and transparency obligations, thus also provide for an expansion of sustainability-relevant accounting. Some of the requirements are already to be implemented from March 2021.
- Regulation (EU) 2016/1011 (Benchmark Regulation) ensures better information on the "carbon footprint" of an investment portfolio. In addition to developing minimum standards for low-carbon investments, two new categories of benchmarks have been introduced. Some of the requirements have already been applicable since April 2020.
- Regulation (EU) 2020/852 (Taxonomy Regulation), which was adopted in April 2020, undoubtedly forms the "core" of the EU's Sustainable Financing Action Plan and further expands on and defines the concept of "sustainability".

The Taxonomy Regulation identifies, among others, (i) climate change mitigation, (ii) adaptation to climate change, (iii) sustainable use and protection of water and marine resources, (iv) transition to a circular economy waste prevention and recycling, (v) pollution prevention and control, and (vi) protection of healthy ecosystems as environmental objectives.

In order to be considered a sustainable company in the sense of the Taxonomy Regulation, at least one of these environmental objectives must be achieved and no other must be substantially violated ("do not substantially harm").

With regard to disclosure obligations in Austria, the Sustainability and Diversity Improvement Act is of particular relevance. It obliges large companies that are of public interest and have more than 500 employees to report (in the management report or in a separate report) on environmental, social and labour issues as well as on measures to respect human rights and to fight corruption and bribery (ie, the ESG factors). In addition, it is necessary to describe the con-

cepts pursued and to indicate the results, the risks as well as the most important non-financial indicators.

Although this would appear to cover only a very small number of companies, the "level down" effect – according to which a company can only fulfil its disclosure obligations itself if, among other things, it can rely on corresponding reliable information from its suppliers – means that many smaller companies will also be affected.

2. Authorisation

2.1 Providing Financing to a Company

There are three basic routes for banks to be authorised to provide loan financing on a commercial basis to companies domiciled in Austria:

- application for an Austrian banking licence pursuant to Austrian Banking Act BWG (granted by the Austrian Regulator FMA) or application for a CRR-credit institution's licence (granted by the ECB; a CRR-credit institution fulfils the criteria of Article 4 para 1 CRR); this option is certainly not viable for one-off transactions and obtaining an Austrian banking licence or a CRR-credit institution's licence typically involves meticulous and in-depth preparation over an extended period, in particular in preparation of fulfilling legal requirements for credit institutions and preparing an appropriate business plan (which is subject to review by the competent regulator);
- establishment of a branch (*Zweigstelle*) by a CRR-credit institution from another EU member state (by way of so-called passporting; ie, having the competent regulator from the home member state notifying the requisite banking licence to the Austrian regulator); or
- direct rendering of services under the EU freedom of services, the most common approach for non-Austrian CRR-banks who wish to commercially engage in the lending business in Austria without establishing a permanent presence.

Non-banks may generally only engage in the lending business in Austria if and to the extent that such activity would be exempted from a banking licence for an Austrian entity – eg, by way of the acquisition of loan portfolios by special securitisation purpose entities.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

In terms of absolute restrictions on granting loans, subject to the fulfilment of the regulatory criteria (see **2.1 Providing Financing to a Company**), there are no specific restrictions on foreign lenders intending to provide debt financing to Austrian borrowers.

3.2 Restrictions on Foreign Lenders Receiving Security

There are no legal impediments or restrictions for receiving securities or guarantees which would deviate from the rules that would apply to an Austrian lender.

3.3 Restrictions and Controls on Foreign Currency Exchange

There are no restrictions, controls or other concerns on and regarding foreign currency exchange which would deviate from the rules that would apply to an Austrian creditor.

3.4 Restrictions on the Borrower's Use of Proceeds

There are no restrictions on the borrower's use of proceeds from loans or debt securities.

3.5 Agent and Trust Concepts

Austrian civil law recognises the necessary concepts in order to implement agent and trust structures in Austria in the form of an agency agreement (*Auftragsvertrag*), which may be combined with the granting of a power of attorney (*Stellvertretung*), as well as the possibility of certain rights being held by a trustee in its own name but for the account of a third party (trustor).

As a consequence, agency and trust concepts are frequently used in the documentation of Austrian law-governed loans in the form of customary security agency agreements.

A certain degree of complexity (and potential insecurity) is entailed by these structures since Austrian civil law differentiates between so-called accessory securities (*akzessorische Sicherheiten*) and non-accessory securities (*nicht-akzessorische Sicherheiten*), whereby the former provide for a stringent link between the existence/validity of the security and the underlying (secured) claim. By way of example, pledge (and mortgage) agreements are strictly accessory so that any defect of the underlying legal relationship (such as the invalidity of the loan claim) as well as the (full) redemption of the claim would automatically result in the lapse of the relevant security right. While structures providing for accessory security rights (such as pledges) being granted to a security agent (which typically hold parts of, but not the entire, loan claim) are customary in Austria these have not been tested (or expressly accepted) by the courts.

This risk does not apply to so-called non-accessory security, which includes (inter alia), the transfer of property for security purposes (*Sicherungsübereignung*).

These uncertainties are known by domestic, and widely accepted by foreign, participants in the Austrian lending market and the relevant qualifications are customarily included in (enforceability) legal opinions as a standard market practice.

3.6 Loan Transfer Mechanisms

Austrian civil law recognises the concept of assignment, pursuant to which lenders' rights (but not obligations) may generally be unilaterally transferred from the original or former creditor (assignor) to a new creditor (assignee). However, there are regulatory limitations to this procedure stemming from the fact that Austrian banking secrecy (*Bankgeheimnis*) prohibits the disclosure of customer data by banks to third parties; exceptions apply (eg, for the conduct of legal disputes with a borrower or for the purposes of certain investigations by authorities) but these will generally not apply to performing loans. Waiver and consent language – inter alia, permitting disclosure of information on a loan and lender to a potential syndicate partner or assignee – is therefore frequently used in non-consumer loans and is standard market practice for loans designed for syndication.

Since this is not a satisfactory structure in practice (in particular, with respect to performing loans), the entirety of any rights and obligations arising from a loan agreement may be transferred by way of transfer of contract (*Vertragsübernahme*); such transfer requires the consent of all parties involved. It is customary, however, that the loan documentation contains the relevant in-advance consent of the borrower, which is permissible under certain circumstances.

Austrian law-governed security rights will typically transfer alongside the underlying legal relationships (and statuary law provides for a claim of the new lender to have any such security rights transferred from the former lender).

Specific to Austrian law is the possibility of a new creditor, with the consent of the borrower, redeeming outstanding debt with the former creditor thereby causing (against payment) an ex lege transfer of any related security rights. This would, however, require that any such outstanding payments that are due, as a result this redemption (*Einlösung*) structure would typically not be a viable option in relation to performing loans. The method is frequently used in restructuring scenarios because it permits the swift and secure transfer of security rights.

By way of an alternative, Austrian law would also permit risk transfer structures not resulting in a transfer of the position of the lender of record (such as sub-participations) which would, however, not imply a technical transfer of a claim or security right.

3.7 Debt Buy-Back

Debt buy-back by a borrower or a sponsor is generally permitted under Austrian law provided that either a repayment is due or voluntary early prepayments are permitted on a contractual basis. In addition, consumer borrowers have (as a general rule) a mandatory right of early repayment.

3.8 Public Acquisition Finance

Austrian law does not recognise or regulate the concept of "certain funds".

However, public take-over transactions (subject to the Austrian Takeover Code (*Übernahmegesetz*), which implements the European Take-Over Directive) require debt or equity funding for the acquisition of the target shares (under the hypothesis of a full acceptance of an offer) to be available and to be certified by an independent expert and for that certificate to be included in the published offer documentation.

Other than that, in particular, in private transactions, "certain funds" provisions are not mandatory, but may be used by way of contractual arrangement on a case-by-case basis.

In terms of documentation, there is a divide in the Austrian lending market. On the one hand, local (also major) Austrian banks frequently provide debt financing to their (existing or new) customers on the basis of in-house standard documentation (in conjunction with their general terms and conditions), which may be considered "short form". On the other, international banks targeting the Austrian market, as well as Austrian banks aiming at the syndication of their lending engagements, increasingly refer to "long form" documentation that is frequently structured and drafted along the lines of the standard provided by the Loan Markets Association (LMA).

In the context of public M&A (take-over) transactions, no public filing or other disclosure of the underlying financial documentation is required; the attestation/confirmation on the available funding of the independent expert to be included in the offer document will suffice as a matter of law.

3.9 Recent Legal and Commercial Developments

There are no recent legal or commercial developments that have required changes to the legal documentation.

3.10 Usury Laws

There are no regulatory limitations on interest charged to customers (borrowers).

However, there are certain basic limitations under Austrian civil law prohibiting "usury" (*Wucher*). There is a requirement, however, that such interest (agreements) may only then be considered prohibited and unenforceable if and to the extent that the agreed interest rate is clearly disproportionate to market terms and conditions and an agreement to that effect could only be reached (on record) due to the weakness, predicament or inexperience of the borrower. In the retail segment (consumer loans), various information duties and formal requirements apply.

In commercial lending, relevant examples are almost non-existent.

3.11 Disclosure Requirements

There is no rule or law regarding the disclosure of certain financial contracts.

However, pursuant to the Austrian Banking Act (BWG) banks are required to publish their annual financial statements, as well as their consolidated financial statements. The BWG contains some specific rules on the illustration of financial statements of credit institutions. Banks have to report on a regular basis (depending on the reporting obligation quarterly or semi-quarterly) to the FMA as supervisory authority. These reports are not necessarily publicly available unless it is required by other provisions. In addition, banks must meet several disclosure requirements under the CRR (as amended by CRR II), for example a description of the main characteristics of the equity instruments issued and the required disclosure of remuneration policies and practices.

4. Tax

4.1 Withholding Tax

Repayments of principal under loan transactions are not subject to withholding tax.

Interest payments made to lenders are not subject to withholding tax as a general rule. Rather, such payments will have to be taken into account for the purposes of the (corporate) income tax of the lender.

4.2 Other Taxes, Duties, Charges or Tax Considerations

There are certain types of security arrangements – such as suretyships (*Bürgschaften*) and assignments (*Zessionen*) – which, on a standalone basis, would be subject to stamp duty; there is an exception, however, when these transactions are entered into for purposes of securing loan obligations (which are, themselves, exempted from stamp duty).

If debt funding is structured by way of the acquisition of loan receivables (on a commercial basis), which Austrian banking law qualifies as "factoring", then such assignment may also be subject to Austrian stamp duty (applied at a rate of 0.8% to be calculated on the basis of the consideration for the acquisition of such loan).

4.3 Foreign Lenders or Non-money Centre Bank Lenders

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 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.

5. Guarantees and Security

5.1 Assets and Forms of Security

Shares

Security rights over shares are the most common security instrument in certain types of financing transactions under Austrian law. Perfection and enforcement vary among the different types of legal forms, of which the limited liability company (*Gesellschaft mit beschränkter Haftung* or GmbH) is by far the most common.

GmbH

Security rights over GmbH shares are typically created in the form of a pledge. While the (full title) transfer in a GmbH share requires the form of (an Austrian) notarial deed, this does not apply to a share pledge which is therefore done only in written form. In order to facilitate enforcement, alongside the GmbH share pledge agreement, the pledgor typically grants a (notarised) power of attorney authorising the pledgee to sell and transfer the shares on their behalf and a (written) voting power of attorney (which will normally only be used in case of default). The perfection of a GmbH share pledge requires the notification of the company; while separate confirmation letters (counter-signed or with confirmation of receipt) were common in the past, in intra-group scenarios, the company frequently co-signs the share pledge agreement proper in order to document proper notification (and perfection).

AG

Since shares in joint stock corporations (*Aktiengesellschaft* or AG) are typically certificated as securities (which is legally prohibited regarding GmbH shares), the major difference between a GmbH and an AG share pledge are the perfection requirements. The AG share pledge agreement (as is the case with the GmbH) requires no specific form and is therefore customarily drawn up in simple written form.

As a basic rule, the perfection of in rem security over movables (such as certificated securities) requires that the pledgee obtains direct or indirect possession (which may be mediated by a third party, such as an account bank, but not the pledgor). Only shares in stock-exchange listed companies (or companies envisaging such admission) and shares traded on a multilateral trading facility (MTF) may be certificated in bearer form; this is effected through a global share certificate and the shares then being introduced into an electronic clearing system. In that case, a pledge may be created by transferring the shares to the pledgee's securities deposit account or blocking the pledgor's account in the pledgee's favour. Registered shares which are certificated (in physical form) must be transferred to the pledge; shares that are not certifi-

cated may only be pledged in accordance with the rules on assignments (ie, notification of the company).

Partnerships

Pledges over shares in partnerships – both limited partnerships (*Kommanditgesellschaft* or KG) and unlimited partnerships (*Offene Gesellschaft* or OG) – do not require a specific form and are therefore commonly drawn up in writing and perfected through notification of the company.

Transfer restrictions

Companies' articles of association frequently provide for transfer restrictions that may include a shareholder consent/resolution requirement for the pledge or a transfer of shares/interest in those companies. In order to avoid risks (such as unenforceability or delays during enforcement) it is advisable to have such requirements removed from the articles or to obtain the requisite consent in advance.

Enforcement

Austrian law provides for court-conducted enforcement proceedings unless there is a specific contractual enforcement arrangement in place between the security holder and the security provider that, inter alia, requires a valuation of the asset prior to its commercialisation (unless there is a defined market or stock exchange price). The requisite rules aiming at preserving the pledgor's interest during enforcement must be followed meticulously when drafting security agreements. Overall, direct enforcement by the pledgee is standard market practice in financing transactions in Austria.

Receivables

Security rights over receivables may be effected either by pledge or full transfer (assignment) of rights (for security purposes); while both forms occur in practice, security assignments are more common as they provide full title to the secured party.

The transfer of receivables requires an (assignment) agreement between the assignor and the assignee (unless the assignor and the obligor have agreed on a valid assignment restriction). However, if an assignment is effected for security purposes, the same requirements as for pledges will apply and disclosure of the pledge/transfer will be required. In the case of receivables not recorded in the creditor's/assignor's books and records (which is rare in business practice), the notification of the obligor is considered sufficient. In the case of receivables being so recorded, Austrian case law has developed an increasingly stringent approach requiring that the pledge/assignment be annotated both in the list of obligors of the assignor as well as in the list of open accounts.

Given the requisite legal restrictions, the notification of the obligor of an assignment/pledge is mostly withheld until an enforcement event occurs.

Pledges and security transfers are not restricted to present receivables of the assignor but may extend also to future receivables or certain classes thereof, if and to the extent that such receivables are properly described in the security agreement.

Cash/Accounts

Cash collateral is most commonly granted in the form of account pledges, which are not subject to specific formal requirements and are therefore typically drawn up in written form. Perfection requires the notification of the account bank. The standard business terms and conditions of Austrian banks contain a pledge arrangement over

any and all assets of the customer transferred to the bank's custody, including accounts with a positive balance. In order to create an effective third-party pledge (to a pledgee other than the account bank), this standard pledge agreement is customarily waived or subordinated.

Real Property

Real property can be provided as security in the form of a pledge (*Hypothek*) under Austrian law. In addition to a pledge agreement, which does not require a specific form, the registration of the pledge in the land registry is required. For this purpose, the pledgor/owner of the property needs to provide a specific consent declaration regarding the registration, which must be notarised.

Multiple pledges over one individual property are possible and will rank towards each other in terms of priority (as per registration in the land register).

The registration of a pledge over real property in the land register is subject to a significant registration fee (1.2% of the secured amount), which is typically borne by the pledgor. Under certain circumstances (abundant other security or impeccable financial standing), lenders may temporarily refrain from the registration while having readily executed pledge documentation in place for immediate registration at their discretion.

Movables

While security arrangements relating to moveable goods (such as equipment or inventory) are not subject to specific formal requirements, Austrian law imposes stringent standards on perfection which either require the physical transfer of the pledged goods or equivalent measures (in the case that a physical transfer is too onerous, transfer "by way of token" will be considered sufficient).

A full title transfer in such goods for security purposes will be possible but is subject to the identical perfection requirements (to avoid circumvention).

Given these requirements, pledge over moveable assets is not common, in particular in relation to such assets as are required for the daily operations of the pledger.

In individual cases, lenders and borrowers agree on pledges on the contents of warehouses. These are, however, subject to strict requirements under case law entailing, inter alia, signage of the goods affected and the engagement of a special guardian, which will be bound by instructions solely of the pledgee and assure that no goods are removed from a warehouse in the absence of the pledgee's consent or in the case of direct replacement.

Intellectual Property Rights

Trade marks pledges do not require a specific form. In terms of perfection, a registration of the pledge (which, however, requires notarisation of the pledgor's consent declaration) is considered necessary and standard.

Patent pledges require a registration in the patent registers.

Copyrights as such may not be pledged or transferred. However, licences may be established or be the subject matter of security rights to achieve an equivalent economic result.

5.2 Floating Charges and/or Similar Security Interests

The concept of a "floating charge", or other universal or similar security interest over all present and future assets of a company, is not recognised by Austrian law. Rather, security arrangements must be made specifically with respect to each and every asset and type of asset and take into account observation of the requisite perfection requirements, which vary significantly.

5.3 Downstream, Upstream and Cross-Stream Guarantees

Austrian law does not restrict downstream guarantees (or other security). However, there are stringent limitations on upstream and cross-stream security.

Distributions to (direct or indirect) shareholders may only be effected by corporations – eg, an AG, a GmbH or a GmbH & Co KG (ie, a limited partnership in which the only unlimited partner is a GmbH) – in the form of formal dividend distributions (based on a balance sheet and appropriate shareholders resolution), in the case of a capital decrease (which also requires a shareholders resolution) or in the form of a potential liquidation surplus.

In addition, a company and its shareholders or affiliates may enter into transactions with each other on arm's length terms and conditions. This requirement entails that the company will only enter into such transactions with its shareholder or affiliates if and to the extent that it would equally (but hypothetically) enter into the transaction on identical terms and conditions with any unrelated third party.

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 under the business judgement rule, in particular the risks involved, in accordance with the above criteria. The entering into of such a transaction may not, in any event, threaten the existence of the company. A breach of the capital maintenance rules would lead to personal liability of the management and nullity of the transaction.

In order to mitigate the relevant risks, limitation language restricting the (potential) enforcement of upstream or cross-stream security arrangements is common in Austria. Since there are no clear guidelines on the admissibility of upstream or cross-stream guarantees (such as the limitation to certain financial criteria), any type of proposed limitation language is necessarily ambiguous to some extent and decreases the commercial value of upstream or cross-stream security significantly.

5.4 Restrictions on the Target

For joint stock corporations (AG), there is an outright prohibition on providing financial assistance in relation to the acquisition of their own shares (including in the form of granting advance payments, loans or providing security to a third party in order to provide such assistance). Exceptions only exist for transactions in the ordinary course of business of credit institutions.

Austrian legislation on other corporations (GmbH) does not contain comparable restrictions. As to substance, however, these are similar to those for the AG in view of the Austrian capital maintenance rules as per Austrian case law.

5.5 Other Restrictions

The most relevant risks in relation to the grant of security guarantees are valuations of the princi-

ples of accessoriness and capital maintenance rules.

In addition to that, Austrian insolvency law provides for an elaborate set of provisions permitting an insolvency administrator to challenge and void certain transactions entered into prior to the opening of the insolvency proceedings of a security provider. The insolvency administrator is entitled to rescind acts of the bankrupt company if:

- such acts have been completed prior to the opening of insolvency proceedings;
- such acts affect the assets of the estate;
- such acts are detrimental to the estate's creditors; and
- a specific rule (subject to additional criteria) on such rescission applies.

In Austria, there are no significant costs associated with the grant of security or guarantees for credit or loan agreements. Besides, no specific prior consent by authorities or statutory interest representation (eg, works council) is required.

5.6 Release of Typical Forms of Security

Formalities on the release of security depend on the type of security that has been granted.

Accessory security (such as pledges or suretyships) will automatically lapse in the event of a full satisfaction of the secured liabilities. In these cases, no specific formal requirements would apply to the "release" of security; nevertheless, release agreements or confirmations on repayment (which may take the form of pay-off letters issued in advance of such payment) are customary.

In the case of non-accessory securities, depending on the type of security, a formal re-transfer or similar act may be required in order to reverse the original creation of a security right.

In case of securities recorded in registers (such as mortgages, trademarks pledges, etc), even if the pledges are accessory securities, certain formal requirements may apply to the deletion of the relevant security right. For instance, the deletion of a mortgage from the land register will only be possible on the basis of a consent to the release issued by the pledgee (executed in an authenticated form).

These requirements and documentary deliverables may cause significant complexity in refinancing transactions where an outgoing lender/security holder would only agree to a release of security (or the issuance of confirmations) upon full repayment and a new lender/security holder insists on the creation/perfection of the security as a condition precedent to draw-down. In these scenarios, escrow arrangements are common market practice.

5.7 Rules Governing the Priority of Competing Security Interests

As a general rule, Austrian rules on the creation of securities follow the principle of priority when it comes to the in rem perfection of security rights.

Contractual arrangements varying this principle are permissible among creditors (eg, in intercreditor agreements in syndicated loan transactions). This, however, would not have to be observed by an insolvency administrator and/or court in the case of enforcement and/or insolvency proceedings.

In syndicated financing transactions, the appointment of a joint agent/security agent constitutes significant mitigation for larger groups of

creditors against this legal concept because the proceeds from an enforcement, or in the course of insolvency proceedings, would be disbursed to the agent/security agent for the account of a larger group of creditors so that internal distribution could be effected as per the agreed terms (and outside of the insolvency proceedings).

5.8 Priming Liens

With financial stress, a company will look for additional liquidity to shore up its finances to avoid covenant defaults under its existing debt. But if a company is already overleveraged, it may need to find creative ways under its existing debt agreements to allow for a new loan using its existing collateral as security. Lenders in the new loan will likely require a senior priority lien on the company's collateral. As a result, all existing loans are "primed" when their liens against the collateral are surpassed by the new loan. Most collateral priming transactions tend to fall under two mechanisms – loopholes or amendments. Under the first, a company uses a loophole within the terms of their loan document to allow it to take on additional senior debt secured by collateral already pledged under a separate credit facility. With an amendment, the company works with requisite lenders to amend the existing loan documents to allow for a new senior loan facility and often "priming" the existing facility as a result.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

The enforcement of (contractual) security rights varies significantly depending on the type of specific securities (and any contractual arrangements in place); while statutory law provides for enforcement of security rights through the courts as a general principle, deviations by way of contractual arrangements between the parties are permissible.

Regarding the most relevant types of security, the following statutory rules and market practice observations apply.

Share Pledges

In the case of shares in a GmbH, it is common market practice to agree on out-of-court enforcement, which entails information to the pledgor, a valuation of the shares and subsequent disposal to the best bidder. In principle, the same applies to shares in an AG; however, if these have a market or stock exchange price, they must be sold at such price without public auction.

Mortgages

In principle, mortgages must be enforced through court enforcement proceedings, which require a public auction of real property, and the involvement of the court is prone to cause delays with the enforcement procedure.

Receivables

In the case of receivables, there is no specific enforcement procedure; rather, the pledgee will be entitled to directly claim payment from the debtor.

Guarantees/Suretyship

For this type of "personal security", there is no specific type of enforcement procedure. Rather, depending on the terms and conditions agreed in the relevant security arrangement (eg, "first demand guarantees"), payment may be requested directly from the security provider (guarantor).

Movable Property

It is common market practice that the court enforcement procedure provided for under statutory law is modified to permit out-of-court enforcement. Movable goods may be sold after a notification to the pledgor, a cooling-off period of one month and by way of public auction. Disposal without such auction is permissible and, in the case of securities, mandatory (see the information about share pledges above) if a stock exchange or market price exists.

The same principles would apply to the enforcement into security rights over intellectual property rights.

6.2 Foreign Law and Jurisdiction

As a general rule, Austrian law and conflict of laws rules permit the choice of a foreign law as the governing law of a contract, even if that contract is to be enforced in Austria; in terms of market practice this would frequently apply to loan agreements governed by German or English law.

Restrictions apply, however, to the granting and perfection of security rights, which, depending on the type of security, is in most instances governed by local (Austrian) law. By way of example, this would apply to pledges over the shares in Austrian companies, pledges over or security assignments of Austrian law-governed receivables, the creation of pledges/mortgages over Austrian real properties, etc.

Therefore, it is common market practice that security rights over assets located in Austria and/or provided by Austrian domiciled transferors/pledgors are documented in Austrian law-governed security documentation.

A waiver of immunity would basically be upheld in Austria.

6.3 Foreign Court Judgments

As regards the enforcement of non-Austrian judgments or awards, there are three basic categories.

Court Judgments From EU Member States

Due to the Brussels Ia Regulation, which applies in Austria, judgments from other member states of the European Union are generally recognised and enforced in Austria without any additional procedures or retrial of the merits of the case. Limited exceptions may apply in the case of substantial deviations from Austrian law (ie, those that contravene the Austrian ordre public).

Court Judgments From Non-EU Member States

Outside the scope of applicability of the Brussels Ia Regulation, enforceability of a foreign court judgment depends on whether there is a bilateral treaty between the home state of a lender/security holder and Austria. As a substantive criterion, Austrian law (on the enforcement of court judgments) requires reciprocity to be ensured under bilateral treaties or regulations. In addition, it is required that the defendant in the enforcement proceedings had the opportunity to participate in the original proceedings before the foreign court and that the relevant judgment may no longer be challenged before the courts and/or authorities of the foreign state.

Enforcement of a foreign (non-EU) court judgment may nevertheless be denied if and to the extent that the enforcement is aimed at an action which may not be enforced or is not permissible under the laws of Austria or if the ordre public would be violated.

Arbitral Awards

Austria has ratified 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, which maintains a leading international arbitral institution (the Vienna International Arbitral Centre or VIAC).

6.4 A Foreign Lender's Ability to Enforce Its Rights

Impediments to a foreign lender enforcing security in Austria are largely technical and administrative. In civil law court proceedings, competent courts may request cost advances (unless the relevant claimant is domiciled in the EU or in a state that is a party to the Hague Convention on Civil Procedure of 1 March 1954); in addition, translation requirements will apply for non-German language transaction documentation.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

As a general rule, any and all claims against a debtor will immediately become due upon the opening of insolvency proceedings. Therefore, there is no requirement for separately terminating, for instance, a loan agreement. Also, under Austrian insolvency law, any agreement on rescission or termination rights, which would apply in the case of the opening of insolvency proceedings, are generally null and void.

In relation to assets that are within the possession of the obligor in an insolvency but subject to in rem rights of third parties (such as pledged assets), Austrian insolvency law provides for specific rights of segregation which will permit that, following enforcement of security, the relevant proceeds will be passed on to secured creditors. If this segregation right is asserted, but disputed by the insolvency administrator (on behalf of the estate), the administrator has the option of redeeming the outstanding debt or initiating separate enforcement proceedings. In cases where turning over an asset to a secured creditor would put the continuation of the debtor's business at risk, the claim for the returning of the asset is suspended for period of six months from the opening of the insolvency proceedings unless such moratorium would cause an undue hardship to the party holding the security interest.

On a separate note, it must be considered that security rights may be challenged or voided by the insolvency administrator if and to the extent that they have been created within certain time limits applied to the opening of insolvency proceedings, and subject to additional criteria.

7.2 Waterfall of Payments

There are two basic categories of creditors: senior creditors (ranking pari passu) and junior creditors. A junior ranking of debt may be agreed in lending documentation (on junior/hybrid financial instruments or subordinated loans) as well as by way of retroactive subordination waiver (*Rangrücktritt*), which would result in the relevant creditor not being repaid in the course of insolvency or liquidation proceedings until and unless any and all non-junior creditors have been repaid. Other than that, statutory law may order mandatory subordination in the case of certain shareholder loans deemed to qualify as equity financing (equitable subordination); this will apply if and to the extent that financing is provided by a qualified shareholder to an Austrian company during a "crisis" (which is assumed if certain financial ratios are fulfilled).

"Quotas" (ie, proceeds obtained in the course of insolvency proceedings) obtained by unsecured senior creditors are typically fairly low; junior debtors (alongside equity holders) do not

typically receive proceeds from insolvency proceedings.

7.3 Length of Insolvency Process and Recoveries

Insolvency proceedings in Austria take an average of three years.

The average satisfaction rate with payment schedules is 31.9%, while the average satisfaction rate with restructuring plans is 38.6%.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

While the Austrian legislature introduced "reorganisation proceedings", which should be initiated if a "need for reorganisation" (*Reorganisationsbedarf*) is identified, in 1997, this regime was and continues to be without any practical relevance.

Besides that, since July 2021 the new Restructuring Act provides a pre-insolvency restructuring regime in line with the Directive (EU) 2019/1023 on Restructuring and Insolvency. A debtor may use the procedures provided by the Restructuring Act to avert insolvency and ensure the viability of its company in the event of "probable insolvency", which is the case if the existence of the debtor's company would be at risk without restructuring. The procedure is not available to companies which are illiquid within the meaning of the Insolvency Act.

The core of the restructuring procedure under the Restructuring Act is a restructuring plan which defines classes of "affected creditors". In order for the restructuring plan to come into effect, the majority of the creditors in each class is required in the first instance; a cram-down is also possible. In addition, the court has to confirm the restructuring plan.

Therefore, other than insolvency proceedings, out-of-court restructuring efforts constitute the prevailing market procedure in Austria. Unless there are specific lending arrangements (such as syndicated loans with market standard majority rules), effective out-of-court restructuring efforts (if a uniform pro rata debt reduction is sought) require, in principle, the consent of all lenders to (i) a definitive settlement (typically requiring a hair-cut), or (ii) organised contractual arrangements with a view to the implementation of a restructuring under stand-still and restructuring contractual provisions. If such a settlement and/or regime is established with (only) majority consent, the dissenting lenders will fully retain their legal position (and remain entitled to full repayment, subject only to a quota reduction in insolvency proceedings).

The same considerations apply to liabilities incurred under bonds. Unlike other (European) jurisdictions, Austrian legislation has not (yet) adopted collective action clauses so that, in principle, the restructuring of a bond (eg, by way of a, possibly temporary, moratorium or hair-cut) would require the consent of all bondholders. Recent Austrian practice has seen individual cases where a special joint representative (*Kurator*) has been appointed in order to represent bond creditors if and to the extent that their joint interests are affected.

In any structuring of such out-of-court settlements/restructuring, the potential risks of an ensuing insolvency and related legal action (such as a challenge or a voidance of pre-insolvency contractual arrangements by an insolvency administrator) must be considered.

Restructuring Within Insolvency Proceedings

Other than typical insolvency proceedings aiming at the full liquidation of a company's assets,

Austrian law provides for restructuring proceedings in the course of insolvency proceedings based on a so-called "restructuring plan" (*Sanierungsplan*). These proceedings provide for a certain minimum of the debtor's liabilities (at least 20%) to be repaid during a maximum period (of two years). As an additional differentiation, these proceedings may be opened by an insolvency court providing for self-administration (in this case, 30% of the debtor's liabilities have to be repaid) of the debtor (where the management bodies would retain their operational responsibility) as opposed to the withdrawal of self-administration (where a restructuring administrator, similar to an insolvency administrator, would take over day-to-day management). While such insolvency court restructuring proceedings can be, and are frequently, initiated without a prior agreement among the creditors of the debtor, it is common in Austrian restructuring practice that the key terms and conditions of such a restructuring settlement before the court are pre-agreed among the majority of creditors of the debtor.

7.5 Risk Areas for Lenders

The key risk or impact of the insolvency proceedings over the assets of a borrower is the fact that the competence for the enforcement of any contractual rights and/or securities is no longer with the creditor or ordinary courts but with the insolvency administrator; while this may not in all instances be a detriment as to substance, it typically causes significant delays.

Other than that, as per their specific set of duties under the insolvency legislation, the insolvency administrator will typically closely scrutinise any and all contractual and, in particular, security arrangements entered into by the borrower for the benefit of a creditor prior to the opening of insolvency proceedings. This may not only result in delays in enforcement, but also in (alleged) claw-back of claims (on the grounds of the nullity/avoidance of contractual arrangements, including the creation of security rights).

8. Project Finance

8.1 Recent Project Finance Activity

In Austria, the majority of project financing is generally in the fields of lifescience, technology, infrastructure and energy. Due to the current economic dislocations, there is currently some noticeable decline in project financing in Austria.

8.2 Public-Private Partnership Transactions

The relevant legislation for the implementation of public-private partnership transactions in Austria involves numerous areas of law (both at the Austrian federal level as well as provincial laws and municipal regulations). Areas of interest involve corporate law (regarding the structuring of a project), general civil law, public procurement, subsidies, zoning and permissions, administrative law in all its variations (environmental, health, other industry-specific laws), etc.

The legal structure of public-private partnerships will largely depend on the type and sector of the project implemented. Possible structures include all standard models, in variations, attributing the property and legal title in the project, the operation and funding to be provided by either the private investor, the public sector or both of these functions jointly; as is commonly recognised in the field of public-private partnership, these forms of co-operation could take the form of the operating model, the co-operation model, the concession model, the contracting model or the leasing model.

In terms of market practice, public private partnership models are applied for a variety of transactions which extend to areas such as roads, logistics, education and, most recently and increasingly, health care. Prior to structuring a project finance transaction in Austria, a full analysis of any and all risks involved would be required, including operational risks, design, development and construction risks and political risks. In addition, from a commercial perspective, the repayment and/or credit risks need to be taken into account.

8.3 Governing Law

In terms of governing law, there are no specific rules as compared to "normal" financing transactions. Therefore, there is a certain degree of flexibility as to the governing law for the lending arrangement proper. For security arrangements, it is customary to agree on the applicability of Austrian law.

8.4 Foreign Ownership

Legal entities registered in the EU/EEA are free to own real property in Austria. Other entities need an official approval to be able to buy real property in Austria. The acquisition of real property by foreign nationals and entities is governed in Foreign National's Property Acquisition Act of each federal state. For example, in Vienna, a legal entity registered in Austria but owned by nationals of third countries by more than 50% of shares is considered a foreign entity and thus requires an official approval for buying real property.

8.5 Structuring Deals

The main issues to be considered when structuring a project finance transaction include both legal and non-legal considerations comprising:

- the technical design, development and construction of the project;
- risks involved in its (factual) operation;
- any political risks (which, apart from surprising changes of legislation, are largely absent in Austria);
- the risk of disputes; and
- the overall credit and repayment risk from a commercial perspective.

Risk mitigation is typically effected by way of conducting due diligence covering the requisite areas (legal, financial, technical, environmental, etc).

The legal forms of preference for project companies in Austria are the GmbH or the GmbH & Co KG. The principal difference between these is the direct attribution of profits and losses to limited partners (ie, tax transparency of the GmbH & Co KG). Also, it must be noted that a GmbH provides great flexibility from a corporate law perspective in that majority requirements and composition of corporate bodies are largely flexible and rights of direction to the management of a project company are statutory.

8.6 Common Financing Sources and Typical Structures

In Austria, the classic bank or savings bank loan is the most widely used form of financing. In the case of a loan, a distinction must be made between an investment loan and an operating resource loan. The investment loan is granted to finance property, plant and equipment (eg, buildings, machinery, vehicles and office furniture), the working capital loan to pre-finance the purchase of raw materials, goods or suppliers.

For the refinancing of exports, Austrian companies can resort to a number of instruments. Flexible mechanisms are available (eg, commer-

cial financing with the principal bank, framework credit or export financing procedure by the *Oesterreichische Kontrollbank* (OeKB), or soft loans for selected markets).

Further sources of financing are equity investments or participation in companies as well as (subordinated) shareholder loans. Private business angels or professional venture capitalists can also be considered as investors.

The issuance of bonds constitutes another alternative to bank debt financing for projects; in Austrian practice, however, this has been rare, likely in view of the typically (small) size of projects (by international standards) and capital markets financing being normally taken out by sponsors/operators on a corporate (but not project) level.

8.7 Natural Resources

Austrian law does not provide for general restrictions on the export or import of natural resources to or from Austria. Exceptions may apply, however, in specific areas, such as under environmental protection laws (in particular, if such resources qualify as waste), arms control, restrictions on the export of products qualifying for "dual use" or, if applicable, sanctions with respect to specific jurisdictions (eg, currently Iran and Russia).

8.8 Environmental, Health and Safety Laws

Environmental, health and safety laws, which may apply to projects, are not governed by a uniform set of rules or supervised by one specific authority. Rather, given the federal structure of the Republic of Austria and its membership in the EU, the relevant provisions may be found in federal and provincial laws, regulations, technical directives or EU legislation.

The competence for the enforcement of the relevant provision lies with numerous authorities at federal or provincial level (including municipalities).

BAHAMAS

Trends and Developments

Contributed by:
Christel Sands-Feaste, Alexandra Hall and Julia Koga da Silva
Higgs & Johnson

Higgs & Johnson is one of the oldest and largest full-service law firms in The Bahamas and has been in existence for over 70 years. The financial services practice group has extensive experience in advising domestic and international banks, trust companies, family offices, financial services and securities firms operating within and/or from The Bahamas on the laws and regulations governing the financial services industry. The team regularly advises clients on regulatory matters, issues relating to licensing, compliance, M&A, KYC, suspicious activity reports, internal policy and procedure manuals, FATCA, CRS and economic substance.

Authors

Christel Sands-Feaste is a partner at Higgs & Johnson, where she leads the firm's practice groups in financial services, securities, investment funds, and fintech. A highly regarded lawyer for her specialist expertise in advising on financing transactions, securities, securitisations, and investment fund structuring, Christel has also developed a keen interest and expertise in emerging digital assets and related fintech. In addition to her professional work, Christel is the current President of The Nassau Chapter of Links Incorporated, was appointed to the first Fiscal Responsibility Council constituted in The Bahamas, as the representative for The Bahamas Chamber of Commerce and Employers Confederation (BCCEC) and is a former director of the BCCEC and former Vice Chairman of the Hospital and Health Care Facilities Licensing Board.

Alexandra Hall is a partner and chair of Higgs & Johnson's government and regulatory affairs practice group and deputy-chair of the firm's tax practice group. She is also a member in the firm's commercial law and private client and wealth management practice groups. She has experience in local tax law, corporate and commercial law, legal issues relating to resort development and operations and gaming law and regulation. She has assisted in various aspects of commercial transactions including securing governmental and regulatory approvals for a variety of businesses. Alexandra regularly advises clients on day-to-day legal issues including licensing and compliance matters as well as other general corporate matters associated with the establishment and operation of a business in the Bahamas.

Julia Koga da Silva is of counsel and a member of Higgs & Johnson's financial services, commercial transactions and securities, and investment funds and fintech practice groups. She is a corporate and commercial attorney with over ten years' experience in mergers and acquisitions, investment funds and financial services matters. Julia has experience co-ordinating M&A transactions, commercial contracts discussion and general corporate affairs, the structuring of new investment funds and legal operations of existing funds and the implementation of corporate governance. She has liaised with public companies, closed companies and limited liability companies and advised foreign investors and foreign companies on their investments in Brazil.

Higgs & Johnson

Ocean Centre
East Bay Street
Nassau
The Bahamas

Tel: +242 502 5200
Fax: +242 502 5250
Email: info@higgsjohnson.com
Web: www.higgsjohnson.com

Current Perspective

With the worst of the COVID-19 pandemic and related restrictions firmly in the past, the Bahamian economy has continued to recover over the last 12 months, primarily due to strong performance in the tourism sector, which some are referring to as "revenge tourism". In the Monthly Economic and Financial Developments Report for July 2023, the Central Bank of The Bahamas indicated that "the growth trajectory of the domestic economy persisted, although at a moderate pace", and this growth is projected to continue for the remainder of 2023. While this positive news is being well received, the cost of living crisis, high inflation, record energy costs and climate change remain at the forefront of the minds of Bahamian consumers (in the same way as applies to consumers in most other countries).

A number of the themes highlighted in the 2022 Trends and Developments chapter have continued to dominate the legal and regulatory framework relating to financial services in The Bahamas, including:

- the continued focus of policymakers on strengthening public finances;
- the ongoing modernisation of the Bahamian payment system; and
- the establishment of a new regulatory framework for the digital assets space.

While not restricted to the financial services sector alone, another important development impacting all Bahamian entities is the recent overhaul of the economic substance legislative framework.

Continued Focus of Policymakers on Revenue Enhancement

As part of the government's ongoing efforts to increase revenue and strengthen public finances, additional human resources were allocated to the revenue collection sections of the Department of Inland Revenue. Meanwhile, the enforcement provisions in various revenue-related statutes, including the Value Added Tax Act, 2014, have been enhanced. In addition, the new Business License Act, 2023 (the "new BLA"), came into force on 1 July 2023, as a part of the annual budget exercise. The new BLA, among other things, repealed the prior Business License Act, 2010, and expanded the categories of businesses subject to business license tax. The requirement for financial institutions to pay an annual tax based on turnover remains.

Ongoing Modernisation of the Bahamian Payment System

The Central Bank of The Bahamas Payment Systems Modernization Initiative is ongoing. 31 December 2024 remains the target date for the elimination of cheque usage. Local financial institutions continue to encourage customers to utilise virtual platforms for the delivery of their services.

Regarding the "Sand Dollar", a digital currency denominated in Bahamian dollars, there have been increased efforts to raise public awareness of it and promote its use as an alternative to cash.

Modernisation of the Regime Related to Digital Assets

The legislation regulating the digital assets space (the DARE Act) was initially implemented in 2020. In 2022, the government of The Bahamas published the Policy White Paper on The Future of Digital Assets in The Bahamas (the

"White Paper"), outlining its vision and policy position on the regulation of the digital assets space over the next five years. The objectives outlined in the White Paper included growing the sector, increasing the attractiveness of The Bahamas for digital assets businesses, establishing The Bahamas as a leading digital assets hub, and encouraging innovation in the fintech space.

In order to address the rapid evolution of the sector and to strengthen the robustness of the regime, the Securities Commission of The Bahamas (the "Commission") confirmed its intention to review and amend the DARE Act during the first half of 2022. As a result, a draft of the Digital Assets and Registered Exchanges Bill, 2023 (the "new Bill"), was circulated for industry consultation earlier in 2023. The new Bill seeks to enhance investor protection while maintaining sufficient flexibility to facilitate innovation. The amendments contemplated include, among other things:

- expanding the scope of digital asset activities which will be subject to regulation;
- the introduction of capital requirements as prescribed by the Commission;
- mandatory ongoing financial reporting (including audited financial statements);
- the mandatory segregation of client assets; and
- enhanced investigation and enforcement powers for the Commission.

It is anticipated that the new Bill will be brought into force later in 2023.

Overhaul of the Economic Substance Framework

The recent overhaul of the regulatory framework relating to economic substance has impacted all Bahamian entities, not just those in the financial services sector. For background, in accordance with international best practices, in 2018, The Bahamas implemented legislation requiring Bahamian entities engaged in certain activities to establish a substantial economic presence in The Bahamas, and for all Bahamian entities to comply with substance reporting requirements. On 1 September 2023, the 2018 legislation was repealed and the Commercial Entities (Substance Requirements) Act, 2023 (the "new CESRA"), was brought into force. The new CESRA, among other things:

- shifted the reporting obligation from the entity itself to its registered agent or, if the entity does not have a registered agent, the Compliance Commission;
- expanded the list of information which must be reported to the competent authority;
- mandates that registered agents or the Compliance Commission obtain this information from each Bahamian entity; and
- made some modifications to the classifications for reporting purposes.

The accompanying guidelines for the new CESRA were circulated on 8 September 2023.

Conclusion

The upward trend of the Bahamian economy is welcomed with cautious optimism. The recent legislative changes reflect The Bahamas' commitment to complying with international best practices and maintaining a sound regulatory framework, while still encouraging innovation.

BERMUDA

Law and Practice

Contributed by:
Erik Gotfredsen, Jemima Fearnside and Larina Kenny
Wakefield Quin Limited

Contents

Wakefield Quin Limited is one of Bermuda's leading law firms, dedicated to providing clients with solution-driven legal advice. It is a full-service firm with a history of advising both local and international clients in the areas of banking, corporate and commercial, property, restructuring and insolvency, trusts, private client and litigation. Clients include public and international corporations, financial institutions, investment managers and insurers. The firm's corporate group has lawyers qualified in seven jurisdictions, expertly navigating complex issues, but retaining perspective to advise on the wider implications of particular transactions. The firm also provides a full range of trust and fund administration, corporate secretarial, accounting and management services, via its affiliates. The firm's trust company recently merged with Winchester Global Trust Company Limited, which now ranks as one of Bermuda's largest fully licensed trust companies.

Authors

Erik Gotfredsen is a director of Wakefield Quin and his practice spans a broad range of sophisticated finance and capital market transactions with an emphasis on debt and equity offerings, banking and financial services, structured and project finance, and secured lending. Erik is routinely instructed by leading international banks, financial institutions, public companies and private equity firms. Erik is admitted in British Columbia, England and Wales, Ontario and Bermuda and has received his B.Com. and LLB from the University of Victoria, Canada and his LLM from Kyushu University, Japan.

Jemima Fearnside is a senior counsel in the corporate department at Wakefield Quin Limited. Having previously worked for national and international law firms in London (UK), Thames Valley (UK) and Palo Alto (CA), Jemima now specialises in corporate reorganisations, debt and equity re-financings (including advising on and negotiating cross-border security structures), and public offerings of securities. Educated in London and then at Leeds University, Oxford Brookes University (winning the Dame Helena Kennedy Law Prize for academic excellence) and London Guildhall University. Jemima is a qualified notary public (England and Wales), a solicitor (England and Wales) and attorney and barrister (Bermuda).

Larina Kenny is an associate in the corporate department at Wakefield Quin Limited. Larina's areas of practice include acting on a wide range of banking and financial transactions for Irish and international financial and corporate institutions. She advises both lenders and borrowers on credit facilities and on security and enforcement issues. Larina also has extensive experience reviewing and advising on non-performing loan portfolios and has acted for purchasers, sellers and financiers of these assets. Larina obtained a Bachelor of Business and Legal Studies (BBLS) and a Masters in Commercial Law (LLM) from University College Dublin and qualified as a solicitor in Ireland in 2010.

Wakefield Quin Limited

Victoria Place
31 Victoria Street
Hamilton HM 10
Bermuda

Tel: +1.441.494.4000
Fax: +1.441.494.4111
Email: egotfredsen@wq.bm
Web: wq.bm

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

As an economy closely linked to the United States, lending transactions involving Bermuda entities have not been immune from the impact of uncertainties caused by post-COVID recovery efforts, high inflation and associated interest rate rises, and the global impact of international energy spikes caused by geo-political issues in Europe and beyond. Although domestic lenders in Bermuda are part of international banking and finance conglomerates, the loan market in Bermuda is dominated by the use of Bermuda special purpose vehicles in cross-border structures and transactions.

Over the last year, there have been no material changes to Bermuda's company or lending laws that negatively affect the rights of secured parties or Bermuda's reputation as a leading creditor-friendly jurisdiction.

1.2 Impact of the Ukraine War

As a result of its close links to the North American market, the financial instability in the Eurozone markets resulting from the Ukraine war has largely bypassed lending and financing transactions in Bermuda. However, the impact of global financial sanctions has prompted greater scrutiny of the use of off-shore entities in structured lending transactions. Despite this, market perception of Bermuda entities in cross-border transactions has been enhanced by Bermuda's status as a tax-compliant and creditor-friendly jurisdiction with an established legal system based on English law.

1.3 The High-Yield Market

The involvement of Bermuda entities in the high-yield debt market is generally driven by external factors such as tax residency, a target investor base, and/or business operational issues, rather than Bermuda factors. The majority of Bermuda entities that do follow this path generally look to the high-yield capital markets in New York.

1.4 Alternative Credit Providers

Over the past 18 months, there has been an increased use of alternative credit providers over licensed banking institutions, particularly when refinancing larger insurance and reinsurance groups, both of which have benefited from regulatory uncertainty in the post-COVID and Ukraine war global market. The use of alternative credit providers taking security over assets in Bermuda has resulted in an uptick in the use of security agents known to the Bermuda Monetary Authority, who are able to take advantage of swift clearance procedures in order to hold and register shares of Bermuda companies on enforcement of security.

1.5 Banking and Finance Techniques

There are few restrictions on financial assistance in Bermuda and as such the use of HoldCo borrower structures with cross-group guarantees, debentures, and other security are commonplace. While preferred equity arrangements are less common, they benefit from strong market confidence in the ability to enforce liens, fixed and floating charges, mortgages, and other lender-friendly protections, typically without the need for judicial intervention.

1.6 ESG/Sustainability-Linked Lending

Initiatives by the Bermuda Stock Exchange and the Bermuda Development Agency have raised awareness of ESG opportunities in Bermuda. Additionally, the increasing appetite for catastrophe (CAT) bonds launched by public and private issuers continue to favour public listings in Bermuda as a global leader in the insurance

and reinsurance market. The Bermuda Stock Exchange has successfully launched several CAT bond offerings in 2023, including the Chinese PICC Property & Casualty Ltd.'s "Great Wall Re" and AXA's "Eiffel Re".

2. Authorisation

2.1 Providing Financing to a Company

The provision of financing to a Bermuda company, whether by a foreign bank or alternative credit provider, does not require that such lender be licensed in Bermuda. Unless security is taken over Bermuda assets (such as real estate situated in Bermuda or shares of a Bermuda company) third-party consents or permissions in order for a Bermuda company to grant security over its assets are generally not required.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Provided the loans are granted from outside Bermuda, there are few restrictions on a foreign lender providing loans to a Bermuda company. Restrictions apply under the Bank and Deposit Companies Amendment Act 2022 where a foreign lender is seeking to open a branch establishment in Bermuda.

3.2 Restrictions on Foreign Lenders Receiving Security

There are few restrictions on Bermuda companies providing security or guarantees to foreign lenders. A Bermuda company may guarantee borrowings of members of its group provided the company has capacity to provide such guarantees and there is a sufficient corporate benefit to the company.

There are special rules that apply if an overseas lender wishes to hold a mortgage over real property in Bermuda, including obtaining the prior consent of the Minister of Finance. If a mortgage taken by an overseas lender is subsequently enforced, any land obtained by such lender (as mortgagee in possession) must be sold within five years to either an individual or entity having Bermudian status or to another appropriately licensed person.

Security over shares of Bermuda companies is generally granted under a charge over shares. Legal mortgages are uncommon. It is recommended that chargors also be required to deliver certain ancillary documents to strengthen their security, including irrevocable proxies and undertakings. Although it is recommended that share charges be governed by Bermuda law, New York or English law may govern share charges if required by the underlying transaction documents. Bermuda exchange control regulations generally require the consent of the Bermuda Monetary Authority prior to any disposition of shares of a Bermuda company, which includes the granting of a security interest in the shares. The Bermuda Monetary Authority has issued a blanket consent in situations where the chargee is a licensed bank or lending institution in certain appointed jurisdictions and the Bermuda Monetary Authority is provided with written notification.

3.3 Restrictions and Controls on Foreign Currency Exchange

Bermuda entities generally used in cross-border transactions are either exempted companies or limited liability companies, each of which is designated as non-resident for exchange control purposes and therefore generally free from restrictions on foreign currency exchange.

3.4 Restrictions on the Borrower's Use of Proceeds

As a result of the geopolitical uncertainty following the outbreak of the Ukraine war, there is greater scrutiny on the use of debt proceeds to ensure compliance with anti-money laundering, anti-terrorist financing, and international sanction compliance. Otherwise, there are few restrictions on the use of proceeds by a Bermuda borrower.

3.5 Agent and Trust Concepts

Agent and trust/trustee structures are commonplace in Bermuda. For alternative credit providers, the use of security agents/trustees previously known to the Bermuda Monetary Authority is employed in situations where security is being taken over shares of a Bermuda company. The rationale is to ensure that the mandatory regulatory approval of the Bermuda Monetary Authority is swiftly procured without impeding transaction timetables. Non-licensed lenders face greater due diligence scrutiny by the Bermuda regulator and, as a result, regulatory approvals can in some instances take longer to procure.

3.6 Loan Transfer Mechanisms

Loan transfer mechanisms are mandated by the contractual documentation, with no Bermuda-specific provisions applicable to such transfers. Transfers may be effected by assignment or novation deed.

3.7 Debt Buy-Back

Debt buy-backs are permitted in Bermuda.

3.8 Public Acquisition Finance

Bermuda has no specific requirements for "certain funds" with both public acquisition finance transactions and private acquisition finance transactions involving Bermuda entities being each subject to Bermuda law without distinction.

3.9 Recent Legal and Commercial Developments

The replacement of LIBOR by SOFR has been the principal change that has required updates to financing and transaction documentation in Bermuda over the past 18 months. Similarly, the introduction of Bermuda's Investment Business Amendment Act 2022 has broadened the scope of what constitutes "investment business" in or from Bermuda, and ensures that all entities conducting investment business in Bermuda fall under the remit of the Bermuda Monetary Authority.

3.10 Usury Laws

There are no laws on usury that limit the amount of interest that can be charged to exempted companies.

In relation to local companies (being a Bermuda company that is at least 60% owned and controlled by Bermudians), a lender may stipulate for, allow and exact on any contract, any rate of interest that is agreed upon. However, a contract which creates or evidences a debt dischargeable in Bermuda dollars by a debtor resident or incorporated in Bermuda at the time of contracting is subject to orders made by the Bermuda Monetary Authority, including maximum rate of interest.

3.11 Disclosure Requirements

Save as required to comply with laws on anti-terrorism financing, anti-money laundering or sanctions compliance, there is no general law regarding disclosure of financial contracts.

4. Tax

4.1 Withholding Tax

Neither Bermuda exempted companies, partnerships nor limited liability companies are subject to withholding tax or similar deductions on payments made to lenders.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Bermuda exempted companies, partnerships and limited liability companies are exempt from taxes payable in Bermuda in respect of loans, guarantees or security (other than in limited situations, including security over real property situated in Bermuda).

Stamp duty rarely applies to documents that are executed by Bermuda companies engaged in international business. However, legal mortgages on real property situated in Bermuda 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 (typically BMD700) will be payable for registering a charge at the Registrar of Companies, depending on the value secured. There is also a BMD95 fee for registering a satisfaction of a charge at the Registrar of Companies.

A fee of between BMD100 and BMD1,300 is payable to the Land Title Registry Office on the first registration of real property. Thereafter, a fee of between BMD50 and BMD400 is levied to register a charge against a registered title.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Foreign lenders can be confident regarding the tax position of lending to a Bermuda entity on "known principles" as Bermuda has 41 Tax Information Exchange Agreements in place in addition to more than 125 multilateral taxation treaty partners.

In 2022, Bermuda received the green light from the OECD/G20 Inclusive Framework (Article 14) on base erosion and profit shifting (known as BEPS). In addition, Bermuda remains committed to ensuring the effectiveness and efficiency of the mutual agreement procedure on the interpretation and application of taxation treaties.

5. Guarantees and Security

5.1 Assets and Forms of Security

Both tangible and intangible assets of a company are available to secure lending obligations. Common collateral includes real property, securities, receivables, cash deposits, contractual rights (including under policies of insurance), inventory and mortgages over Bermuda-registered ships and aircraft.

Registrable security (to ensure priority ranking over subsequent security interests created over the same assets) typically takes the form of a charge. Registration of a charge may be effected by submitting an application to the Registrar of Companies with a signed electronic copy of the charge instrument, and payment of the relevant filing fee, with registration in many cases confirmed on a same-day basis.

There are no perfection requirements in Bermuda, although an equitable assignment (such as an assignment of receivables, contract rights, or bank account balances) may be upgraded to a legal assignment by notice to the relevant counterparty.

Real Property

Security over real property in Bermuda is typically granted by way of either a legal mortgage, where title is transferred to the mortgagee, or an equitable mortgage, where a charge is established without title being transferred to the mortgagee.

When the Land Title Registration Act 2011 (2011 Act) came into effect in 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). 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). This system replaces the historical regime, which required that any legal mortgage or charge be registered in the Book of Mortgages at the Registry General in order to protect a mortgagee's priority position.

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 such a mortgage is subsequently enforced, any land obtained by such company, must be sold within five years to either an individual or entity having Bermudian status.

Share Charges

Security over shares of Bermuda companies is typically granted under 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 default events. It is recommended that chargors also deliver certain ancillary documents to chargees to strengthen their secured position, including undated share transfer forms, irrevocable proxies and undertakings.

Bermuda companies are prohibited from issuing bearer shares. Share certificates do not need to be issued unless required under the company's bye-laws or specifically requested by a shareholder. If issued, share certificates are generally a deliverable under the share charge.

Even though Bermuda exchange control regulations generally require the consent of the Bermuda Monetary Authority prior to the granting of a security interest, the Authority has granted a blanket consent where the chargee is a licensed bank or lending institution.

Receivables

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, executed 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 completed.

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.

Cash Deposits

Bermuda companies may grant security over cash in their bank accounts, which is typically accomplished by way of a fixed or floating charge. The amount of control that the chargee has over the account will determine whether a charge is fixed or floating.

Serving notice on a financial institution will ensure a chargee's priority in relation to subsequent assignees, provided the chargee has no knowledge of the earlier assignment. Service of notice on a financial institution will perfect the security granted by the chargor, regardless of whether or not the financial institution provides an acknowledgment.

Bermuda banks typically require chargees and chargors to enter into a deposit account control agreement to manage the administration of the account, including limiting withdrawals, unless permitted by the chargee and the financial institution's agreement not to exercise set-off rights.

5.2 Floating Charges and/or Similar Security Interests

Floating charges and/or hybrid charges (where a floating charge crystallises to a fixed charge on the occurrence of contractually specified events) are commonplace in Bermuda.

5.3 Downstream, Upstream and Cross-Stream Guarantees

There are no restrictions on financial assistance in Bermuda and, consequently, a Bermuda entity may grant downstream, upstream and/or cross-stream guarantees in lending transactions unless there are specific restrictions in its constituting documents.

In determining whether to approve a guarantee, the directors of the Bermuda entity would need to satisfy themselves that a sufficient direct, indirect or group commercial benefit exists. If the Bermuda entity is insolvent, its directors may be liable for wrongful trading and there is a risk that the guarantee may be void on the basis that it amounted to a fraudulent preference.

5.4 Restrictions on the Target

As many older Bermuda companies still have legacy restrictions in their bye-laws, the constitutional documents of the Bermuda guarantor should be checked to ensure it has capacity to grant the contemplated guarantee. A company's memorandum of association may not set out an express power to provide guarantees; however, the company's objects would typically be sufficiently broad to permit the entry into guarantees that are ancillary to the business of the entity.

5.5 Other Restrictions

Other than as discussed herein, there are no other restrictions in connection with, or significant costs associated with, or consents required to approve the grant of security or guarantees. There are no works council consents applicable in Bermuda.

5.6 Release of Typical Forms of Security

Typically, a deed of release between the chargor and chargee is used to evidence the release of security. Where security is registered with the Registrar of Companies, submission of the deed of release together with a nominal fee is required to register the satisfaction of the charge.

5.7 Rules Governing the Priority of Competing Security Interests

Generally, registration is not required in Bermuda to perfect a security interest. However, to ensure the priority in Bermuda of a security inter-

est granted by a Bermuda company, it needs to be registered at the Registrar of Companies and upon registration, to the extent that Bermuda law governs the priority of the security interest, it will have priority in Bermuda over any unregistered security interest and over any subsequently registered security interest.

In order to register a security interest, a copy of the fully executed charge instrument will need to be filed with the Registrar of Companies, together with the appropriate filing fee. The Registrar of Companies will issue a certificate of registration recording the effective date of registration of the security interest. Registration is effective as at the time of filing and not at the time the Registrar of Companies issues the certificate of registration.

Mortgages and charges over Bermuda land and ships, aircraft, and aircraft engines registered in Bermuda must be filed with separate registers in Bermuda.

Where there are competing security interests between lenders or members of a lender group, these are generally determined by a contractual arrangement, such as an intercreditor agreement or a subordination agreement.

The rights of a secured creditor rank ahead of the claims of unsecured creditors of an insolvent Bermuda entity, save that a floating charge created within 12 months of the insolvency of the chargor is invalid except for the amount of cash paid in consideration for the granting of the charge.

Contractually agreed subordination of secured creditors generally survives subsequent insolvency, save where there is demonstrably a fraudulent preference, or the arrangements are determined to be unduly onerous by a liquidator.

5.8 Priming Liens

Few security interests arise by operation of law that can prime a lender's security interest that has been properly registered in Bermuda.

Recent transactions relating to Bermuda entities involved in US Chapter 11 bankruptcy exits have seen an increase in debtor-in-possession loans with existing secured lenders primed by the exit lenders. Generally, these are perceived as last-resort financing arrangements structured by onshore counsel, with Bermuda involvement ancillary to the principal transaction.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

In general, secured lenders are not involved in competition with unsecured lenders, except to the degree that any balance remains due after realising on their collateral. Secured lenders will compete amongst themselves and provided that all of their security is properly perfected and registered, insolvency law will generally not interfere with the competing claims. Secured lenders may enforce collateral in accordance with the contractual agreement creating the security interest, without the requirement to seek court intervention or other enforcement steps. The instrument creating the security interest will reference the events allowing for enforcement and remedies including possession, receiver appointment, and/or sale.

In the absence of a statutory power of sale for a mortgagee or chargee, any security instrument must include an express power of sale to

enable the secured lender to take advantage of this remedy.

The appointment of a receiver is commonly used to assist with gathering and realising assets. Bermuda law does not grant any statutory power to a secured lender to appoint a receiver and this remedy, including all of the receiver's powers, should be specially set out in the applicable security documents. Any appointment of a receiver under the terms of a security document must be notified to the Registrar of Companies within seven days of the appointment.

6.2 Foreign Law and Jurisdiction

Contractual agreements on governing law and the jurisdiction of courts outside Bermuda are commonplace, with many financing arrangements concluded under US or English law. In general, arrangements as to foreign governing law and jurisdiction are enforceable in Bermuda save in limited circumstances such as where the application of foreign law would be contrary to public policy in Bermuda or where there is litigation pending on the same matter in another jurisdiction.

6.3 Foreign Court Judgments

A final and conclusive judgment in the superior courts of England (as well as Australia, Bahamas, Barbados, Dominica, Gibraltar, Grenada, Guyana, Jamaica, Leeward Islands, Nigeria, St. Lucia and St. Vincent) against a Bermuda company, based on a contract under which a sum of money is payable (not in respect of multiple damages, or a fine, penalty, tax or other similar charge) (each a Money Claim) would, on registration in accordance with the Judgments (Reciprocal Enforcement) Act 1958, be enforceable in Bermuda without the need of any retrial of issues or any re-examination of underlying claims, provided that the judgment: (i) is final and conclusive (notwithstanding that any appeal may be pending against it or it may be still subject to an appeal); (ii) has not been given on an appeal from a court which is not a superior court; and (iii) is duly registered in the Supreme Court of Bermuda.

A final and conclusive judgment in a US court against a Bermuda company, based on a Money Claim, may be enforced in Bermuda under the common law doctrine of obligation for the debt evidenced by the US court judgment. When considering whether a US court judgment should be recognised and enforced, such proceeding would likely be successful if (i) the US court was competent to hear the action in accordance with private international law principles as applied in Bermuda and (ii) 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.

Where a foreign judgment is expressed in a denomination other than Bermuda dollars, the registration may involve the conversion of the judgment debt into Bermuda dollars. However, the current policy of the Bermuda Monetary Authority is to permit payment in the original judgment currency.

A foreign judgment against a Bermuda company can form the basis of a Bermuda statutory demand, even if the judgment has not been registered under Bermuda law, provided that the jurisdiction of the foreign court is not disputed. The non-payment of the statutory demand would be sufficient for a secured lender to seek commencement of winding-up proceedings against the Bermuda company.

The Bermuda International Conciliation and Arbitration Act 1993 gave statutory footing in Bermuda to the UNCITRAL Model Law on International Commercial Arbitration 1985, and provides that enforceable arbitral awards include:

- decisions in preliminary/provisional proceedings;
- decisions or awards by arbitral tribunals granting provisional measures (subject to the discretion of the court, provided that the granting of the measure does not lead to fraud, corruption, injustice or a breach of Bermuda public policy); and
- declaratory awards.

Similarly, Bermuda is party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and recognises awards made under agreements in any jurisdiction that is also party to such convention, without any retrial of the merits of the claim.

6.4 A Foreign Lender's Ability to Enforce Its Rights

Save where a foreign lender may seek to enforce security over land in Bermuda (which requires the permission of the Minister of Finance) or where a chargee wishes to transfer shares in a Bermuda company in the absence of a permission granted by the Bermuda Monetary Authority, generally there are no other specific restrictions relevant to foreign lenders' ability to enforce their rights.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

Save to the extent that a floating charge is created within 12 months of insolvency, secured creditors may enforce their rights regardless of the commencement of insolvency proceedings.

In Bermuda, the concept of a moratorium on enforcement is limited to specific situations where a company enters provisional liquidation, under the supervision of court-appointed provisional liquidators, to restructure the company for the benefit of creditors generally.

7.2 Waterfall of Payments

In general, secured creditors have priority over all unsecured creditors and may enforce their rights outside any insolvency or winding-up process.

In the winding-up of a Bermuda company, debts secured by fixed charges retain first priority, followed by:

- all taxes owing to the Bermuda government and rates owing to a municipality;
- all wages or salary (up to a maximum of BMD2,500 in respect of any one claimant) of any employee for services rendered to the company during the four months before the winding-up;
- all accrued holiday remuneration payable to any employee on termination of his/her employment before or following the winding-up;
- certain amounts due by the company as employer of any persons under the Contributory Pensions Act 1970 or any contract of insurance;
- 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);
- secured creditors under floating charges; and
- unsecured creditors and secured creditors to the degree that their collateral was insufficient to repay the secured obligations.

Upon an insolvency of a Bermuda company, the failure of a secured creditor to perfect its security or register the security as a charge in Bermuda does not entitle the liquidator to set aside the security (for the benefit of the company's unsecured creditors). It is generally accepted that registration does not constitute perfection and so the method of perfection for a particular asset class is a matter of common law. Where a creditor has failed to perfect its security, there is a risk that a subsequent creditor with a security interest in the same asset may be able to achieve priority over that asset by being the first to register its security. Registration affects priority among the secured lenders. If no secured party has registered its security, priority is determined by the time of the creation of the applicable security interest.

7.3 Length of Insolvency Process and Recoveries

It is difficult to determine the length of a typical insolvency process in Bermuda as in many cases provisional liquidation orders are sought in tandem with a US Chapter 11 proceeding or a scheme of arrangement in another jurisdiction, to enable a cross-group moratorium on enforcement actions and allow breathing room for restructuring proposals to be finalised.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Bermuda has no equivalent to US Chapter 11 proceedings to enable company rescues or reorganisations outside of insolvency proceedings. A hybrid, light-touch alternative is a provisional liquidation order granted by the Bermuda court in tandem with a Chapter 11 proceeding, or scheme of arrangement in another jurisdiction, to enable a cross-group moratorium on enforcement actions.

A scheme of arrangement is a compromise between the company and its creditors that, with the approval of the Bermuda court, allows a company to implement the compromise. The scheme must be a compromise between the company and its creditors as opposed to the creditors themselves. A scheme of arrangement requires a meeting of each class of affected creditors to be convened. The statutory supermajority vote that must be obtained at the scheme meeting is a majority representing at least 75% in value of each affected class of creditors in attendance and voting. Following the relevant vote, a hearing would be held before the court to sanction the implementation of the scheme. If the scheme is sanctioned by the court, it is binding on all creditors. A minority creditor is bound by the scheme and cannot apply to the Bermuda court to vary its terms.

The provisional liquidation process has been used extensively in Bermuda for a variety of reasons. It is used where it is desirable to restructure an insolvent company rather than to wind it up and liquidate its assets.

A provisional liquidation order is a court-overseen supervision process with court-appointed provisional liquidators working with existing management to maximise creditor returns. Applications for provisional liquidation orders may be commenced by creditors or by the company, demonstrating support from creditors for the proposal, and is seen as a key interim step to allow for restructuring ahead of winding-up orders. Under a provisional liquidation, a moratorium on legal proceedings typically would be granted so long as the provisional liquidators stay in office.

7.5 Risk Areas for Lenders

The following provisions relating to reversible antecedent transactions may result in certain transactions being rendered void or invalid.

Fraudulent Preference

Any conveyance or other disposition of property made by a Bermuda company within six months prior to the commencement of its winding-up will be considered invalid if it was made with the intent to fraudulently prefer one or more of the company's creditors at a time when the company was unable to pay its debts as they became due. A payment to a secured party would not typically be considered preferential. However, if the intention exists, a granting of security could be considered preferential and set aside. The commencement of a company's winding-up is the date that the company resolved to be wound up and, if no such resolution exists, the time of presentation of the court petition that led to the company's winding-up.

Fraudulent Conveyance

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 when 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:

- is owed a debt by the transferor within two years after the disposition;
- on the date of the disposition, is owed a contingent liability by the transferor, where the contingency giving rise to the obligation has occurred; and
- 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.

Floating Charges

Where a Bermuda company is being wound up, a floating charge on the undertaking or property of the Bermuda company that has been created within 12 months of the commencement of the winding-up will be invalid (unless it is proved that such company immediately after the creation of the charge was solvent). This is with the exception 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.

Therefore, a floating charge will be valid if the creditor provided new value at the time of, or in consideration for, the security. Otherwise, the floating charge is void to the extent that the creditor did not provide new value, unless the creditor proves that the company was not insolvent at the time of the charge's creation.

Disclaimer of Onerous Property

From the commencement of a winding up of a Bermuda company, the liquidator may with leave of the Bermuda court disclaim any property belonging to such company, whether real or personal, including any right of action or right under a contract (and therefore any corresponding obligation), which the liquidator believes to be onerous for such company to hold or is unprofitable or unsalable. We do not believe that a liquidator of a Bermuda company could disclaim some transactions under an agreement to which it is a party and not others.

8. Project Finance

8.1 Recent Project Finance Activity

Bermuda's geographical footprint limits domestic project finance activity, however Bermuda vehicles (whether exempted companies, partnerships or limited liability companies) are frequently used in project financing arrangements outside Bermuda for asset-based lending structures. The natural resources sector, both in the Far East and in Norway, has seen an uptick in the use of Bermuda vehicles in pan-jurisdictional financings, both public and private, with China Oil & Gas and Star Energy being two such examples.

8.2 Public-Private Partnership Transactions

With a land mass of only 20.6 sq. miles (53.2 sq. km) and a population of 65,000, public-private partnership transactions in the jurisdiction are limited. One of Bermuda's first projects was the Acute Care Wing of the King Edward VII Memorial Hospital, which closed in 2010. In December 2020, the newly built L.F. Wade International Airport opened in Bermuda, having been a successful BMD400 million public-private partnership transaction. The Bermuda government continues to be committed to further public-private partnership transactions and in the coming years it is expected that additional transactions will be announced.

8.3 Governing Law

Other than for local employment arrangements, which must be governed by and determined in accordance with Bermuda law, project documents can be governed by foreign law and disputes determined accordingly.

8.4 Foreign Ownership

Subject to certain exceptions, any non-Bermudian seeking to acquire real property in Bermuda must acquire a licence from, and/or obtain the permission of, the Bermuda government to be able to own and enforce rights pertaining to Bermuda real property.

One such exception is the relatively new Economic Investment Residential Certificate programme, which enables individuals, plus their spouse and minor dependents, who invest BMD2.5 million in certain Bermuda industries, sectors, charities, or government programmes to receive residency rights.

8.5 Structuring Deals

In general, other than for issues that have been discussed herein, there are no Central Bank regulations applicable to Bermuda project financing transactions, and no taxes payable in Bermuda for Bermuda exempted companies, partnerships or limited liability companies and, as a result, the main issues that need to be considered when structuring a project financing transaction will likely arise from jurisdictions other than Bermuda.

8.6 Common Financing Sources and Typical Structures

Project financings involving Bermuda entities are typically international project finance transactions, with financing sources dictated by reference to market sector, geographical location and regulatory factors outside Bermuda.

8.7 Natural Resources

Bermuda has limited natural resources of its own, though a 19-acre commercial solar energy generating plant developed by Saturn Energy started to provide domestic energy supplies in 2021. Bermuda has committed to 85 percent

renewable energy by 2035. To achieve this, Bermuda has committed to 21 MW of solar, 60 MW of wind and 100 percent electric public transport by 2030.

8.8 Environmental, Health and Safety Laws

No environmental, health and safety or community consultation laws apply in relation to international project finance transactions carried out outside of Bermuda.

For project financing initiatives within Bermuda, the Regulatory Authority of Bermuda is typically involved as it regulates all communication networks, submarine cables and the electronic sectors in Bermuda. The Bermuda government's Department of Environment and Natural Resources has a broad mandate to protect Bermuda's environment and responsibly manage its natural resources. For employees in Bermuda, the Department of Health ensures that all employers operating in Bermuda comply with the Occupational Health and Safety Act 1992.

BRITISH VIRGIN ISLANDS

Law and Practice

Contributed by:
Michelle Frett-Mathavious and Melissa Thomas
Harneys

Contents

Harneys is a global offshore law firm with entrepreneurial thinking built around professionalism, personal service and rapid response. Open, progressive and personable, they provide advice on British Virgin Islands, Cayman Islands, Cyprus, Luxembourg, Bermuda and Anguilla law to an international client base which includes the world's top law firms, financial institutions, family offices, investment funds and private individuals. Their network is one of the largest among offshore law firms, with locations in major financial centres across Europe, Asia, the Americas and the Caribbean, allowing them to provide services of the highest quality to clients in their own languages and time zones.

Authors

Michelle Frett-Mathavious is a partner in Harneys' banking and finance practice group. She advises a range of corporate and institutional clients such as onshore law firms, banks and other financial institutions, funds and corporations on finance and corporate matters related to BVI and Anguilla law. Specialising in offshore law for more than 20 years, Michelle has extensive experience in syndicated finance, structured debt, asset finance, bond and note issuances, project finance, project and property finance transactions, insolvency, receivership and Islamic finance. She has worked on a number of complex and high-profile finance transactions and has extensive expertise in property and project finance transactions in Asia and Europe. Until recently Michelle also sat as a member of the BVI's General Legal Council.

Melissa Thomas is an associate in Harneys' banking and finance practice group in the BVI with experience advising on a range of banking and corporate matters. On the financing side, she advises both lenders and borrowers on a broad range of secured and unsecured finance transactions including project, property, aircraft and ship finance and debt capital markets.

Contributed by: Michelle Frett-Mathavious and Melissa Thomas, **Harneys**

Harneys

Harney Westwood & Riegels LP
Craigmuir Chambers, PO Box 71
Road Town
Tortola

Tel: +1 284 494 2233
Email: bvi@harneys.com
Web: www.harneys.com

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Trends in the British Virgin Islands (BVI) loan market largely mirror those of the major global financial centres. The BVI has established a unique position in the global financial system, notably through its flexible corporate structures, making it a popular and highly regarded jurisdiction for cross-border financing transactions.

Within the wider macroeconomic context, recent economic cycles coupled with a tightened regulatory environment onshore affecting the way in which financing is obtained have inevitably impacted both deal flows and structuring. Factors such as increased market volatility, tightening of monetary policy (including higher solvency and liquidity requirements for banks), de-risking by institutional and other lenders and high inflation leading to higher interest rates have affected the onshore lending landscape. These shifts have had a ripple effect, influencing cross-border financing transactions as well.

The overall net effect has been a reduction in new lending by institutional lenders and a more rigorous and often protracted vetting process for borrowers, often leading to delayed access to credit for corporates. To fill the credit gaps created by these tighter financing conditions within the traditional banking sector, companies have increasingly turned to capital markets to address liquidity issues, leading to an increase in bond and note issuances involving BVI corporate vehicles and private credit.

1.2 Impact of the Ukraine War

Like many other jurisdictions, the BVI has not been immune from the far-reaching effects of the Russia/Ukraine war. The war was the catalyst for a huge shock to the global economy, straining supply chains and elevating prices within the energy and food sectors to unprecedented levels.

A key immediate impact of the war on the BVI stemmed from the imposition of co-ordinated and rigorous international sanctions on Russian and Belarusian banks, corporates and individuals by the United States, the United Kingdom and various EU member states. The effects of the sanctions were further exacerbated by the suspension of operations within Russia by several international businesses followed by their

departure from the country. As a jurisdiction that adheres to the highest regulatory standards, the BVI also imposed the relevant sanctions and the combined impact of these actions has been significant within the global financial system, significantly impacting financing transactions involving Russia, Belarus and Ukraine.

Against a backdrop of international sanctions and increased social consciousness, a culture of enhanced scrutiny has been ushered in for cross-border financing transactions involving Russian and Belarusian entities, banks and individuals and transactions with a nexus to Ukraine. Extreme care and diligence have become features of cross-border transactions and this enhanced approach appears to be here to stay (at least for the short to medium term) because of the potentially far-reaching impacts of breaching sanctions.

With respect to contractual terms, none have become entrenched thus far but the implications for the drafting of certain contractual terms within facility agreements (and supporting credit documentation) will likely continue to evolve over time. Current indicators suggest some utility in giving broader consideration to standard provisions or terms within finance documents, particularly representations and warranties (such as those dealing with compliance with laws and sanctions, regulatory matters and the use of proceeds (since facility agreements will often restrict the use of loan proceeds) in violation of sanctions).

1.3 The High-Yield Market

This market has proven an important source of alternative funding for corporates seeking liquidity for CAPEX and other purposes, providing a platform for larger companies to seek financing at a time when bank financing was less accessible for various reasons. The market has facilitated funding access within a structure that is less onerous than standard credit facilities and tends to be characterised by inherently flexible covenant packages. This has proven attractive to issuing corporates and the past few years have been characterised by a surge in issuances, particularly for entities operating within the property markets across Europe and Asia in particular.

Issuances with a cross-border component are structured onshore, often as global notes, featuring a trustee which acts as agent for the holders (effectively promoting uniform treatment between holders) and ensuring that amounts recovered by a trustee are distributed to all holders on a pro-rata basis in accordance with a predetermined waterfall. Structures will often also incorporate security over bond (or note) collateral while preserving the holders' ability to transfer their notes without requiring re-execution of security documentation in the case of incoming transferees.

1.4 Alternative Credit Providers

Senior bank financing is the most common form of cross-border debt financing but funding through private credit, the capital markets and mezzanine funding have also increased. The latter forms of financing provide corporates with access to credit at lower rates, often with more flexible terms than found in traditional bank facility agreements. The structuring is largely guided by onshore considerations while ensuring that these also work from a BVI law perspective.

1.5 Banking and Finance Techniques

In addition to the other forms of financing outlined herein, convertible debt instruments are also used. The decision on the choice of warrants or options will typically be made onshore (with the documentation drafted so as to per-

mit the debt holder the right to convert the debt into equity upon the occurrence of certain trigger events).

1.6 ESG/Sustainability-Linked Lending

The consequences of climate change have ushered in a trend toward "green investing" and "green financing". Both have become more evident within the transactional landscape as a demand for and allocation of financing towards greener purposes across the globe has continued to gain footing. Financing is a key feature of any such investment and while most financing transactions are typically structured onshore, BVI's tax neutrality and flexible corporate regime (which facilitates the formation of BVI companies with either wide or restricted objects) has continued to make the use of BVI vehicles within lending transactions in this space quite attractive for lenders/investors and borrowers alike.

The evidence suggests that financial investors, asset managers and institutional lenders have shifted attention towards ESG/sustainability issues in recent years, seeking more ESG-focused growth. The shift towards environmentally beneficial investments and finance opportunities has in turn heralded a trend towards more green and sustainable finance. An increasing number of transactions classify as "Green Project Finance", with many funding environmental projects such as wind and solar farms or otherwise facilitating the conduct of business with a reduced carbon footprint.

2. Authorisation

2.1 Providing Financing to a Company

There are no special requirements or procedures to which banks or non-banks need to adhere in order to be authorised to lend to a BVI company within the context of cross-border financing transactions. It is typically not necessary for such entities to be authorised or otherwise qualified to conduct business in the BVI, save where they seek to operate in or from within the BVI.

Banking institutions operating within the BVI and offering banking services within the BVI are required to be licenced under the Banks and Trust Companies Act (1990). However, if the relevant lenders are not engaging in activities that constitute soliciting business within the BVI (in which case regulatory licences would be required), no authorisations would be required in the BVI.

Where any non-bank lender is also a BVI corporate entity, it will need to ensure that any authorisations required in accordance with its constitutional documents and principles of good corporate governance are obtained. Where such a lender is a BVI company or limited partnership, it will also need to ensure that it is operating in compliance with the economic substance laws of the BVI (ie, those relating to banking business and finance and leasing business – both of which are considered "relevant activities" attracting certain requirements for BVI business companies or limited partnerships considered "tax resident" in the BVI).

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

A foreign lender which is not conducting business in the BVI will not be required to comply with the licensing requirements or legislation which apply to lenders operating in the BVI. A foreign lender will not be considered to be conducting business in the BVI simply by virtue of entering

into a financing transaction with a BVI counterparty and provided the lender is not operating in contravention of BVI law in this regard, there are no restrictions under BVI law which would apply in respect of its ability to provide loans to BVI counterparties.

3.2 Restrictions on Foreign Lenders Receiving Security

There are no particular restrictions that would apply. The commercial laws of the BVI operate in a creditor-friendly manner and the granting of security and guarantees by a BVI company and other legal entities is often central to the structure of cross-border financing transactions.

Most security documents and guarantees are foreign law governed and provided the relevant foreign law requirements for the valid creation of the security or guarantee are satisfied, BVI law (and the courts of the BVI where appropriate) will generally recognise and give effect to the security or guarantee granted by a BVI entity.

3.3 Restrictions and Controls on Foreign Currency Exchange

There are no government controls or exchange controls that operate within the BVI and there are no exchange controls imposed on foreign lenders under BVI law.

3.4 Restrictions on the Borrower's Use of Proceeds

There are no restrictions on the borrower's use of proceeds from loans or debt securities from a BVI perspective but the use of the proceeds will typically be prescribed within the relevant documentation.

3.5 Agent and Trust Concepts

The BVI courts recognise the concepts/roles of agent and trustee and BVI's legal system supports the ability of entities operating in those roles to take the benefit of security, to transfer or assign the benefit of security and to enforce the relevant security in accordance with the agreed upon terms and conditions of the applicable security documentation.

3.6 Loan Transfer Mechanisms

The transfer of debt owed by a BVI company is common and the mechanisms relating to the transfer of loans and security interests will typically be set out in the relevant transaction documentation. The underlying loan and security documentation will often be governed by onshore law and similarly, where applicable, any sale or sub-participation will also be governed by those laws.

There is no way to assign a chose in action (such as a debt) or other property right under BVI law; as such, where a party intends to transfer legal title to a right in action under BVI law, this is generally done by way of novation. A chose in action may be transferred in equity. In such cases, enforcement necessitates that notice of the assignment be given to the security provider.

3.7 Debt Buy-Back

Transactions will be structured onshore and controls and parameters will be set out within the relevant credit agreements. Provided all local law considerations for structuring the transaction are properly considered (including any BVI law considerations relevant to any of the BVI companies involved) and the transaction is legally and structurally permissible under each, BVI law will give effect to it.

3.8 Public Acquisition Finance

Financing transactions will be structured onshore and will therefore conform with the requirements applicable to the acquisition of public compa-

nies requiring "certain funds" under the laws of the relevant onshore jurisdiction. Similarly, the form of documentation will typically be guided by onshore legal considerations.

3.9 Recent Legal and Commercial Developments

While certain amendments to the BVI Business Companies Act 2004 (the Business Companies Act) came into effect in the first quarter of this year (including, but not limited to, changes providing for the immediate dissolution of BVI companies which are struck off the register of companies and the requirement for BVI companies that are not listed publicly, regulated in the BVI or already engaged in filing a BVI tax return), none of the relevant changes have necessitated any changes to our BVI law-governed documentation.

3.10 Usury Laws

There are no applicable usury or interest limitation laws in the BVI that would restrict the recovery of payments generally or the performance of a BVI company of its contractual obligations. However, under BVI law transactions considered "extortionate credit transactions" are vulnerable to being set aside where the rate of interest provided for by the relevant transaction documents is grossly exorbitant or otherwise contravenes ordinary principles of fair trading.

3.11 Disclosure Requirements

With the exception of the requirement for directors to disclose any conflicts of interest they may have in connection with any particular transaction and any other contractual or procedural notice requirements, there are no disclosure requirements specific to the BVI.

4. Tax

4.1 Withholding Tax

Withholding tax is not payable in the BVI and while certain sums may be deducted or withheld from payment made in connection with financing arrangements in certain jurisdictions, such payments are not required under BVI law.

4.2 Other Taxes, Duties, Charges or Tax Considerations

There are no stamp duties, income taxes or other duties which are imposed within the context of standard financing transactions. However, where a BVI company or limited partnership with legal personality has charged assets, registration with the BVI Registry of Corporate Affairs (the BVI Registry) would be advisable to secure priority under BVI law and this will attract a filing fee of USD200 per filing. In addition, while most BVI companies do not own real property in the BVI, where security is given over BVI shares, where the BVI company owns an interest in real property in the BVI, any transfer of its shares will attract stamp duty under BVI law.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Foreign lenders (ie, lenders operating outside of the BVI) will not generally be subject to taxes or other levies under BVI law and as a result there are no tax considerations that would apply to such entities.

5. Guarantees and Security

5.1 Assets and Forms of Security

Lenders will have access to the usual range of assets by way of security (including, but not necessarily limited to, real estate, moveable and immovable property, securities, claims and

receivables, cash deposits and intellectual property).

Real Estate

The most common form of security involving security over land is a legal mortgage and the formalities for creation will depend upon the laws of the jurisdiction where the real estate is located.

Tangible Movable Property

The form of the relevant security will be determined by any local law requirements applicable to the jurisdiction where the property is located. Assets such as aircraft and yachts are often owned by BVI companies and often used as security for lending. A typical aircraft financing transaction would involve an aircraft mortgage and assignments in connection with aircraft and engine maintenance support agreements as well as insurances and warranties and a typical yacht financing transaction would include a ship mortgage (and deed of covenants) and assignment of insurance.

The formalities for creation will depend upon the laws of the jurisdiction in which the relevant asset is located and/or registered. The BVI Mortgaging of Aircraft and Aircraft Engines Act 2011 facilitates an aircraft and security registration system in the BVI for the purposes of regulatory oversight.

The Virgin Islands Shipping Registry (VISR) facilitates the registration of vessels and ship mortgages in the BVI (in accordance with the Merchant Shipping Act 2001). For any ship mortgages registered with the VISR (in the statutorily prescribed form), priority is determined by the date and time of registration. Mortgages may be registered in respect of previously registered vessels or vessels still under construction and a priority notice can also be registered in respect of a proposed mortgage, thus maintaining priority of the interest in the vessel.

Financial Instruments/Securities

Security can be taken over the shares owned by a BVI company and over shares in the company itself (the BVI shares). The form of security will generally be guided by commercially agreed terms between the parties as well as the laws applicable to the shares. Security over shares owned by a BVI company in a foreign company will typically take the form of a share mortgage, charge or pledge (depending on what is required/permissible under the laws governing the shares). Security over BVI shares may take the form of a legal charge or a legal or equitable mortgage but will most often take the form of an equitable mortgage.

While BVI law expressly permits security over BVI shares to be foreign law governed, such security is also often BVI law governed. A charge or mortgage over BVI shares need not take any particular format but must be in writing, signed by or with the authority of the registered holder and must expressly indicate:

- the intention to create a mortgage or charge; and
- the amount secured by the mortgage or charge and how that amount is to be calculated.

Where the share mortgage or charge is foreign law governed, it must comply with any requirements under its governing law in order to be valid and binding (and the remedies thereunder will also be governed by the foreign law while the rights between the mortgagor or mortgagee as a member of the BVI company and the BVI company itself will be governed by the memo-

randum and articles of association of the company). Where the governing law is BVI, certain statutorily prescribed remedies will be available to the mortgagee or chargee (subject to any provisions or limitations within the share mortgage or charge).

Lenders will also require a notation evidencing the existence of the share security to be entered in the register of members of the relevant BVI company. This is an important step for a lender taking the benefit of an equitable security interest in BVI shares as it acts as notice to potential third parties of the existence of the security. The option also exists for the annotated register of members to be publicly filed with the BVI Registry where the parties wish to proceed on this basis.

It is also worth noting that while shares in a BVI company regulated by the BVI Financial Services Commission (FSC) may be the subject of security, the prior consent of the FSC is required.

Claims and Receivables

Jurisdiction-specific requirements applicable to the relevant assets will typically determine the form of security and will often take the form of assignments (eg, assignments of rental income).

BVI law does not currently provide for the legal assignment of intangibles (such as choses in action). There is therefore no statutory concept of an assignment by way of security. As a result, an assignment of a receivable (including by way of security) will take effect as an equitable assignment under BVI law and should always have the benefit of notice to a security provider in order to facilitate possible enforcement.

Cash Deposits

Security may be given by BVI companies over cash deposits in accounts held in any jurisdiction and will typically be governed by the laws of the jurisdiction where the accounts are located. Where security is given over cash deposited in bank accounts located in the BVI, an arrangement that includes the co-operation of the account bank will generally be necessary in order to facilitate enforcement since there are no statutory provisions relating to security over cash deposited in BVI bank accounts.

Intellectual Property

Security given by BVI companies over intellectual property is typically provided in the form of a debenture. The BVI has a patents and trade marks registry and the governing legislation provides for registration and protection of trade marks in the BVI and related matters including the charge and assignment of trade marks. A trade mark can be charged in the same manner that any other personal or movable property may be charged and under the BVI's Trade Marks Act 2013 an assignment of a registered trade mark, including an assignment by way of security, will not take effect unless it is (i) made in writing and (ii) signed by or on behalf of the assignor or its personal representative.

Once effective, the grant of a security interest over a registered trade mark or any right therein will be registrable by the Registrar of Trade Marks, Patents and Copyright in the BVI.

Security may also be granted over fungible and future assets of a BVI Company.

For most types of security given by BVI companies, no particular perfection requirements are necessary under BVI law for the validity or enforceability of the security. However, it is

standard for particulars of the relevant security to be registered in the publicly maintained register of registered charges kept at the BVI Registry upon payment of the applicable filing fee to preserve the priority of the relevant security interests under BVI law. Once filed, the particulars (ie, the entry in the register of registered charges of the relevant company) will be searchable and will provide notice to third parties of the relevant security interests. Priority is determined in accordance with the date and time of this public registration.

5.2 Floating Charges and/or Similar Security Interests

All assets security and floating charges are permitted under BVI law and may be governed by the laws of the BVI or any other jurisdiction which permits the granting of such security. BVI companies will often provide a floating charge in addition to fixed charges over specific assets.

Where a BVI company grants security, particulars thereof are registrable in the company's register of registered charges and its private register of charges in accordance with the Business Companies Act. A registered floating charge will rank behind a subsequently registered fixed charge unless the floating charge contains a prohibition or restriction on the power of the BVI company to create any future charge ranking in priority to or equally with the charge.

5.3 Downstream, Upstream and Cross-Stream Guarantees

BVI companies have wide powers generally and may give guarantees which are upstream, downstream or cross-stream in nature. Such guarantees are a standard feature of lending transactions involving BVI companies as there are no particular limitations or restrictions on giving such guarantees. Structuring will typically take place onshore so any issues relating to adequate credit support are addressed at that level. For BVI law purposes, a BVI company, subject to its memorandum and articles of association, may guarantee the obligations or liabilities of itself or a third party. The BVI company's directors should approve its entry of the guarantee and in certain instances, shareholder approval should also be obtained.

Upstream and cross-stream guarantees may be considered to be distributions under BVI law and directors should ensure that the necessary solvency test is considered when giving such guarantees (ie, they must be satisfied that (i) the value of the BVI company's assets exceed its liabilities and (ii) it would be able to pay its debts as they become due). The authorising resolutions must also contain a statement to this effect as a failure to satisfy the solvency test immediately following the distribution could result in a shareholder having to repay the distribution and financial cost for directors to repay any sums not recoverable from the shareholder; therefore, care should be taken to comply with the legal requirements for making distributions.

5.4 Restrictions on the Target

There is no statutory prohibition against financial assistance under BVI law. Subject to its memorandum of association, a BVI company's powers will extend to giving financial assistance to any person in connection with the acquisition of its shares.

5.5 Other Restrictions

While there are typically no restrictions in connection with the granting of security or guarantees by BVI companies, any lender should conduct due diligence to ensure that the company has the capacity and power to provide the security or guarantee.

A lender should have regard to the constitutional documents of the relevant entity to ensure there are no impediments to its capacity to contract. If dealing with a BVI company that has been incorporated as a restricted purposes company, the objects clause of its memorandum and articles of association should be reviewed to assess its capacity to enter into the security documentation or guarantee. While the vast majority of BVI companies will not fall into this category, a lender should review (i) the constitutional documents of the relevant company to determine whether there are any restrictions on the activities in which it may engage and (ii) corporate authorisations adopted by its directors (and where appropriate) its shareholders expressly approving entry into the documentation.

Given that directors of BVI companies must be guided by certain statutory and common law duties, there will be instances where the approval of both the directors and shareholders should be obtained where the company seeks to guarantee or secure the obligations of a third party.

5.6 Release of Typical Forms of Security

The mechanism for the release of security will typically be guided by onshore considerations and the lex situs of the secured assets and the documentation may be foreign law governed or BVI law governed (the latter often being the case with BVI shares).

Where a BVI company or BVI limited partnership with separate legal personality has charged assets and particulars of the security have been publicly registered with the BVI Registry, once the security has been validly released, a notice of release can be filed with the BVI Registry in a statutorily prescribed format by either (i) the relevant company or limited partnership or a legal practitioner in the BVI, authorised to act on its behalf or (ii) a registered agent of the relevant company or limited partnership or a legal practitioner in the BVI acting on behalf of the chargee. Upon completion of the de-registration, a Certificate of Release/Satisfaction is issued by the BVI Registrar of Corporate Affairs (the "BVI Registrar").

5.7 Rules Governing the Priority of Competing Security Interests

The Business Companies Act prescribes a structure for determining the priority of competing security interests for security given by BVI companies. Priority is determined by registration of particulars of the security interests with the BVI Registrar in a publicly maintained "register of registered charges". Registration provides priority over (i) a relevant charge created by the company that is subsequently registered with the BVI Registrar in accordance with section 163 of the Business Companies Act and (ii) a relevant charge that is not so registered.

Public registration determines priority although it should be noted that (i) a registered floating charge will be postponed to a subsequently registered fixed charge unless the floating charge contains a prohibition or restriction on the power of the relevant company to create any future charge ranking in priority to or equally with the charge; and (ii) such priority can be varied by agreement or consent.

Priority for security registered against BVI limited partnerships with legal personality are also determined in accordance with public registration of the relevant security particular with the BVI Registrar.

Contractual subordination is permissible and (assuming the transaction is not voidable by a

liquidator) such provisions will generally survive the insolvency of a company.

5.8 Priming Liens

Within the context of cross-border financing transactions, such security interests will typically be guided by the location of the assets of the relevant company. Such liens are most commonly provided for within the structure of guarantees and certain security documents, such as security given over accounts with foreign lenders.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Security interests are enforceable in accordance with the terms of the security documentation and such documents will typically be governed by the laws of the jurisdiction in which the assets are located. In most instances, the documentation will be foreign law governed since BVI companies will rarely have assets in the BVI.

BVI law governed security documents will most often create security over BVI shares and where they take the form of a BVI law-governed mortgage or charge, the Business Companies Act entitles a mortgagee or chargee to sell the mortgaged shares subject to any provisions to the contrary or other limitations in the security document. There is also an entitlement to appoint a receiver over the mortgaged shares, who, subject to any provisions to the contrary in the security document can (i) exercise the voting rights attached to the mortgaged shares, (ii) receive distributions in respect of the mortgaged shares and (iii) exercise other powers and rights of the mortgagor or chargor in respect of the mortgaged shares. A well-drafted security document will generally facilitate statutory out-of-court enforcement rights to be exercisable immediately (or as otherwise agreed) upon the occurrence of events of default in order to prevent potentially lengthy default cure periods (and delayed enforcement action).

For foreign law-governed security documents, the Business Companies Act provides that the available remedies are governed by the foreign law and the document itself. The practical effect of this is that the enforcement should be guided by and conducted in accordance with the governing foreign law (but BVI law advice should be obtained prior to enforcement action).

6.2 Foreign Law and Jurisdiction

It is standard for financing transactions to feature documentation that provides for foreign governing laws and the submission of the parties to such jurisdictions in addition to the waiver of immunity from suit or enforcement of a judgment. Such provisions are valid under BVI law and are upheld as valid by the BVI courts.

6.3 Foreign Court Judgments

Judgments for a definite sum may be enforced in the BVI (i) through registration under the Reciprocal Enforcement of Judgments Act 1922 (REJA) or (ii) at common law.

In the case of the former, the option for registration would apply where (i) the judgment was issued by the High Court of England and Wales or Northern Ireland, the Scottish Court of Session, or the courts of countries to which reciprocity has been extended (including the superior courts of the Bahamas, Barbados, Bermuda, Trinidad and Tobago, Belize, St Lucia, St Vincent, Grenada, Guyana, Jamaica, New South Wales (Australia), and the High Court of the Federation of Nigeria); and (ii) the judgment was for a sum

of money, provided the following three conditions are met:

- the application must be made for registration of the judgment within twelve months of its date or such longer period as the BVI court may allow;
- the BVI company must not be appealing or have the right and intention to appeal; and
- the BVI court must consider it just and convenient that the judgment be so enforced.

A judgment obtained in a non-REJA court is not registrable but may be treated as a cause of action in itself and sued upon as a debt at common law so that no retrial of the issues is necessary in which case an appeal is irrelevant unless a stay of execution has been granted.

Whether registering a judgment under REJA or suing upon a judgment as a debt at common law, it will be necessary that:

- the court had jurisdiction in the matter and the BVI company either submitted to such jurisdiction or was resident or carrying on business within such jurisdiction and was duly served with process;
- the judgment given by the court was not in respect of penalties, fines, taxes or similar fiscal or revenue obligations;
- in obtaining judgment there was no fraud on the part of the person in whose favour a judgment was given or on the part of the court;
- recognition or enforcement in the BVI would not be contrary to public policy; and
- the proceedings under which judgment was obtained were not contrary to the principles of natural justice.

Arbitral awards in respect of a final and conclusive monetary award may also be enforced in the BVI in accordance with the Arbitration Act 2013 with the leave of the BVI High Court.

6.4 A Foreign Lender's Ability to Enforce Its Rights

A foreign lender will generally be able to enforce its rights under the relevant transaction documents (particularly security documents) but should conduct due diligence to ensure no capacity or authority issues operate as an impediment to a BVI company's ability to contract.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

Once a liquidator is appointed, they have custody and control of all of the assets of a BVI company (subject to a statutory trust to be applied in accordance with the BVI Insolvency Act 2003 (the Insolvency Act) for the benefit of the general pool of creditors). Except in instances where the court has so approved, proceedings may not be commenced or continued against a BVI company, no alteration may be made to the liabilities or status of the shareholders and the shareholders cannot exercise or alter any powers under the company's memorandum and articles of association. Once appointed, a liquidator is tasked with assessing and collecting in the assets of the relevant company and assessing claims for payment.

Liquidation will generally affect contractual and property rights (such as the ability of a liquidator to disclaim onerous property and the risk of certain transactions being set aside or otherwise varied by the court as voidable transactions upon application by a liquidator – see **7.5 Risk Areas for Lenders**). However, the rights of secured creditors in respect of a company's assets will

remain unaffected (except insofar as they may be vulnerable as voidable transactions). There is no stay on their right of possession or enforcement of their security and they need no special order of the court in order to enforce their rights. Secured creditors have the option of either seeking to enforce their security interests directly over the relevant assets (as they have the right to do so outside of the liquidation process) or they may elect to surrender their security and claim in the liquidation as unsecured creditors would. The latter option will rarely be one that is advantageous to a secured creditor and so will not typically be a path chosen in such circumstances. However, where a secured creditor believes that the assets subject to the security are insufficient to meet the secured claims, they may value the assets and then claim in the liquidation for the balance (following completion of enforcement, if all of the secured claims are discharged and a surplus remains then the secured creditor must account to the liquidator for that surplus).

Unsecured creditors can submit a claim in writing to the liquidator, supported by documentary evidence and the liquidator will then either admit or reject the claim (whether in whole or in part). In the latter case, any such rejection must be provided to the creditor with notice specifying the reasons for rejection. The appointment of a liquidator is done principally for the benefit of creditors and the liquidator's overriding duty will be to take control of the assets and realise what is owed to creditors (with any surplus being returned to the members of the relevant company where appropriate).

7.2 Waterfall of Payments

Secured creditors operate outside of the insolvency process and are generally able to enforce their claims against the relevant assets outside of the liquidation.

Once appointed, a liquidator will then pay out the proceeds of liquidation based on the statutory priority scheme which provides for the application of the relevant proceeds in the following order:

- first, to the costs and expenses properly incurred in the liquidation in accordance with the prescribed priority;
- second, in paying the preferential claims admitted by the liquidator in accordance with the provisions for the payment of preferential claims/creditors prescribed;
- third, in paying all other claims (ie, those of unsecured creditors) admitted by the liquidator; and
- fourth, in paying any interest which is payable on any claim in the liquidation of a company in respect of the period after the commencement of the liquidation; and
- finally, after paying all of the foregoing, any balance is then distributed between the members and former members who have claims against the relevant company arising in their character as a member.

7.3 Length of Insolvency Process and Recoveries

A typical application to appoint liquidators must be adjudicated upon within six months after filing. That period can only be extended by an order of the court if it is satisfied that "special circumstances" exist and no retrospective consent can be given. Any extension must be for a period not exceeding three months, although extensions can be granted for additional periods (in special circumstances).

Most creditor applications are dealt with within the six-month period and usually well before the end of that period. The court does not generally like to adjourn matters more than once and as a

result, it is possible in a straightforward case to have the application listed and heard within six weeks of issue provided the advertising requirements have been complied with (this covers the time between issue of the application and its determination).

However, if the creditor's application is based on a statutory demand, the process will be lengthier. Debtors are allowed at least 21 days from the date the demand is served to respond. If no counter-application is filed to set aside the demand, this will add at least an extra 21 days to the overall timeline.

Where a debtor wishes to dispute the debt, they may apply to set aside the statutory demand but must do so within 14 days of the date of service of the demand. The court may not extend this deadline. Once such an application is made it is essentially a matter of having the application listed and heard, which is difficult to predict in terms of time. The court generally seeks to list and dispose of applications to set aside in a time-efficient manner but a contested application does extend the overall time period.

An unsuccessful application tends to accelerate the process once the application is listed since the creditor can rely on the statutory demand and the debtor cannot rely on the same grounds to defeat the application to appoint liquidators.

A definitive response with respect to recoveries would be difficult to provide as this will depend on the circumstances of each individual case. However, given the fact that many BVI companies are holding companies the recovery rate is likely to be high.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency Arrangements

BVI law features certain mechanisms that permit insolvent companies sufficient breathing room for restructuring. These are broadly structured as arrangements, of which there are three types:

- a plan of arrangement under section 177 of the Business Companies Act;
- a creditor's arrangement under Part II of the Insolvency Act; and
- a scheme of arrangement under section 179A of the Business Companies Act.

Plan of arrangement

where the directors of a company determine that it is in the best interests of the company or the creditors or members thereof, the directors of the company may approve a plan of arrangement that contains details of the proposed arrangement.

Once the directors have resolved to approve a plan of arrangement, an application is made to the BVI court for approval of the proposed arrangement and the BVI court has wide powers to take a range of actions, including (but not limited to) determining whether approval should be obtained and the manner of such approval.

Once court approval has been obtained, the directors have confirmed the plan, provided notice to all relevant parties and obtained their consent, articles of arrangement are filed with the BVI Registrar. A certificate evidencing the filing is then issued and the arrangement is effective from the registration date (or such later date, up to 30 days later, as specified in the articles).

Scheme of arrangement

Where a compromise or arrangement is proposed between a company and its creditors, or any class of them, or between the company and its members, or any class of them, the BVI court may order a meeting of the relevant group to be summoned in such manner as the BVI court directs. If the company is in administration, the application may be made by the company, a creditor or a member. If the company is in voluntary liquidation or if an Insolvency Act liquidator has been appointed, the application may be made by the relevant liquidator.

Creditors' arrangement

Where the directors of a BVI company believe on reasonable grounds that the BVI company is or is likely to become insolvent, they may resolve to appoint a licensed insolvency practitioner as interim supervisor of the proposed creditors' arrangement and the relevant insolvency practitioner must accept or endorse the appointment. The proposed arrangement may include a range of matters, including, but not limited to, cancellation of all or any part of the company's liability and varying the creditors' rights or the terms of the debt.

Where the relevant company is in liquidation, the liquidator may appoint themselves as the interim supervisor and once appointed they are required to file notice of their appointment with the BVI Registrar within two business days. Once appointed, the principal duty of the interim supervisor will be to prepare a report on the proposal for the company's creditors. The group of creditors will then be able to consider the proposal at a meeting and where creditors holding 75% or more of the relevant company's debt approve the proposal it will pass. The chairman of the meeting will then provide each creditor with a report outlining the outcome of the meeting and the list of creditors and debt due to each and will file a copy with the BVI Registrar. Insofar as the proposal is approved, the supervisor will be required to file notice of their appointment with the BVI Registrar and the proposal is thereafter binding upon the relevant company, its members and creditors.

Under the Insolvency Act, the rights of (i) a secured creditor, and (ii) a preferential creditor, may not be adversely affected by a creditor's arrangement without their consent and a creditor's arrangement most notably differs from the other two forms of arrangement in that:

- there is no requirement for an application before the BVI court (although creditors who believe that they have been "unfairly prejudiced" may seek court intervention); and
- a licensed insolvency practitioner must act as supervisor of the arrangement.

7.5 Risk Areas for Lenders

In certain circumstances, transactions entered into by a BVI company in the period prior to going into liquidation may be vulnerable as voidable transactions. In such instances, a liquidator of the relevant company can petition the BVI court to review a transaction as a voidable transaction. Creditors and third parties have no independent right to make such an application.

There are four types of voidable transaction under BVI insolvency law, and there is a notable degree of overlap in relation to the rules that regulate them.

The four types, with brief descriptions, are as follows:

- unfair preferences – where a creditor of the company is unfairly put into a better position than other creditors shortly before liquidation;
- undervalue transactions – where the company enters into a transaction where it gives up far more than it receives shortly before liquidation;
- voidable floating charges – where the company grants a floating charge (other than for new value) shortly before liquidation; and
- extortionate credit transactions – where the company receives credit on grossly exorbitant terms before liquidation.

Each of the types of voidable transaction has three core requirements:

- entry into the transaction during the relevant vulnerability period;
- entry into the transaction when the company was insolvent, or the transaction must have caused the company to become insolvent (and for these purposes "insolvent" excludes balance-sheet insolvency from the definition); and
- the transaction must not be within the relevant safe harbour.

Voidable Transaction Tests

The tests for each type of voidable transaction are outlined below.

Unfair preference

A transaction that puts a creditor in a position which, in the event of liquidation, will be better than the position they would have been in if the transaction had not occurred is potentially an unfair preference. It is not necessary under BVI law to show any intention to prefer. In principle, granting a security interest, or a transaction that gives rise to a right of set-off, will normally be capable of being an unfair preference. Sometimes simply paying a creditor can constitute an unfair preference to that creditor.

Undervalue transaction

Where the company gives a gift, or otherwise receives no consideration, or enters into a transaction where the consideration that it receives (in money or money's worth) is significantly less than the consideration that it provides, this potentially constitutes an undervalue transaction. In considering whether there has been an undervalue transaction, the court will look at the totality of the transaction, rather than one isolated aspect of it.

Voidable floating charge

Any floating charge created within the vulnerability period and whilst the company is insolvent is a voidable floating charge, but subject to the safe harbours set out below.

Extortionate credit transactions

A credit transaction is extortionate if it requires the debtor to make payments (whether unconditionally, or upon the occurrence of certain contingencies) which are grossly exorbitant or otherwise grossly contravenes ordinary principles of fair dealing. In determining whether a credit transaction is extortionate, regard shall be had to such evidence as is adduced concerning the degree of risk accepted by the creditor (which will usually be high if the company is insolvent). It is important to note that the transaction must be more than simply unfair; it must reach the level of being oppressive.

Vulnerability Periods

The vulnerability period depends on the type of voidable transaction. For an extortionate credit transaction, it is five years. For all other types it is usually six months, but two years if the transaction was entered into with a "connected person"

(as defined under BVI law). In each case, the period is the period preceding the date of commencement of liquidation (which will normally be the date of the order, but may be a different date if the company enters liquidation voluntarily).

Where the company enters into either an unfair preference or an undervalue transaction with a connected person, in addition to the longer vulnerability period, it is presumed that:

- the company was insolvent or that the transaction caused it to become insolvent; and
- the relevant safe harbour does not apply unless proved otherwise.

Safe Harbours

Each of the voidable transactions, other than extortionate credit, has a designated safe harbour for transactions to protect good faith arm's length attempts to rescue the company from insolvency. If a transaction qualifies for the relevant safe harbour, it will not be considered a voidable transaction.

Unfair preference

A transaction is not an unfair preference if it takes place in the ordinary course of business.

Undervalue transaction

A transaction is not an undervalue transaction if:

- the company entered into the transaction in good faith (subjective test) and for the purposes of its business; and
- at the time when it enters into the transaction, there were reasonable grounds (objective test) for believing that the transaction would benefit the company.

Voidable floating charge

A floating charge is not voidable to the extent that it secures money advanced or paid to the company at the same time as or after creation of the charge, or similarly reduces or discharges a liability, or supplies assets of value, and any relevant interest thereon.

Court Orders

Once a court is satisfied that the criteria for a voidable transaction apply, it has wide a discretion in relation to the orders that it can make (including, in theory, making no order at all, if deemed appropriate). In essence, it may:

- set aside the transaction, in whole or in part;
- for an unfair preference or undervalue transaction, make such orders as it sees fit for restoring the parties to their positions as if the transaction had not been entered into; and
- for extortionate credit transactions, order a variation of the terms of the transaction, the return of sums already paid, surrender of any security provided and the taking of accounts.

Power to Disclaim Onerous Property

A liquidator also has the right to disclaim onerous property, which applies to unprofitable contracts and assets of a company that are unsaleable or not readily saleable or which may give rise to a liability to pay money or perform an onerous act. Any such attempt by a liquidator requires filing of notice with the court, following which they must within 14 days provide notice to each person who is (to their knowledge) affected by the disclaimer.

While the discretion is one which may be exercised by a liquidator, it may not be exercised without limitation. For instance, in the case of contracts considered to be unprofitable, it would be insufficient to seek to disclaim any such con-

tract simply on the basis that it would yield a small profit or is financially disadvantageous.

There is no option for partial disclaimer – the contract or property must be disclaimed in its entirety and there is also no option for disclaimer of a contract that has been fully performed by a company. Any rights and benefits that have already vested are also beyond the reach of any attempt at disclaimer. It is beyond the power of a liquidator to seek to "take back" obligations that have already been performed or rights already conferred and for this reason a liquidator will typically be unable to disclaim security interests granted by a company on this basis.

8. Project Finance

8.1 Recent Project Finance Activity

BVI companies continue to be a feature of cross-border project financing transactions. Much of the activity within the project financing arena tends to involve some element of bank financing and while last year has seen a slowdown in the volume of financing activity involving new projects, there has been steady activity with respect to amendments to existing financings for projects with ongoing capital requirements, primarily within the areas of real property and ESG given the push towards increased sustainability.

8.2 Public-Private Partnership Transactions

While we are not aware of any notable public-private partnership transactions (involving BVI companies locally) over the past year, the commercially-oriented environment of the BVI is one that would support such transactions. The legislation and legal requirements for completion of such transactions will depend on the nature and structure of the relevant partnership and any cross-border issues that may apply.

8.3 Governing Law

Transactions will typically be structured onshore and the relevant supporting transaction documentation (with the exception of any security documents in respect of BVI assets such as BVI shares that may be BVI law governed) will be governed by the laws of the relevant onshore jurisdiction. The parties may contractually agree to submit to the jurisdiction of any court or arbitration for the settlement of disputes in connection with the relevant transaction.

8.4 Foreign Ownership

Ownership of an interest in real property located in the BVI by a foreign company will require a Non-Belonger's Land Holding Licence (NBLHL) issued by the BVI Ministry of Natural Resources and Labour. In the case of a BVI company that mortgages its interest in real property located in the BVI in favour of a foreign lender, the relevant company may do so by way of a legal mortgage. While the terms of the mortgage may vary, a legal mortgage would typically operate in the usual manner and would require the transfer of legal title to the land to the foreign lender, subject to the requirement for the land to be re-transferred to the relevant company upon satisfaction of the obligations secured thereby. As the secured creditor, the foreign lender wouldl be granted powers to deal with the land in the event of a default.

8.5 Structuring Deals

Cross-border deals will be structured onshore while having regard to any local law requirements or considerations (for instance environmental issues relevant to the location of the relevant project). There are no applicable Central Bank regulations or restrictions on foreign

investment but foreign companies will likely require certain licences to conduct business within the BVI (such as a Trade Licence from the Department of Trade, Investment Promotion and Consumer Affairs and where it will hold an interest in real property, a NBLHL). BVI's corporate regime is one which is flexible and where a BVI company is designated as the project company, its memorandum and articles of association may be drafted with restricted purposes, tailored to the needs of the project (ie, a Special Purpose Company) or they may be drafted with a wide objects clause which permits the relevant company to engage in any activity which is permissible under BVI law.

The BVI is a party to various tax information exchange treaties; however, in keeping with international practice, information is only provided to competent authorities in certain circumstances.

8.6 Common Financing Sources and Typical Structures

Projects will tend to be structured and operated outside of the BVI and the decision as to the most viable and efficient sources of funding will be made onshore. While the majority of project financing transactions will be bank funded, bond or note issuances as well as private credit and equity provide alternative sources of funding for corporates (usually larger ones) in order to meet or supplement the needs of a given project.

8.7 Natural Resources

The BVI relies upon its reserve of natural resources to enhance its tourism product. Its most notable natural resource is its marine ecosystem/biodiversity and it has recently secured a grant from the Resilience, Sustainable Energy and Marine Biodiversity Programme (a programme that supports the sustainable human development efforts of Caribbean Overseas Countries and Territories). The BVI has no known mineral reserves and does not engage in mining activities.

8.8 Environmental, Health and Safety Laws

There is currently no BVI legislation that provides for lender environmental liability.

BULGARIA

Law and Practice

Contributed by:
Mr Nikolay Cvetanov, Mr Boris Lazarov, Ms Anelia Licheva and Mr Kristian Anadoliev
Penkov, Markov & Partners

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Contributed by: Mr Nikolay Cvetanov, Mr Boris Lazarov, Ms Anelia Licheva and Mr Kristian Anadoliev,
Penkov, Markov & Partners

Penkov, Markov & Partners (PM&P) is a full-service, leading law firm providing quality legal service to, and legal representation of, clients in Bulgaria. The firm has approximately 50 partners and associated lawyers and several external legal consultants. Since its establishment in 1990, in the wake of the democratic changes in the country, the firm has blended the ease and thoroughness of experienced lawyers with the eagerness and ingenuity of young colleagues, brought together by their commitment to legal issues and their customised approach to clients. PM&P is a member of Lex Mundi, FLI Net and Lex Adria and was the first law firm in Bulgaria certified under ISO 9001 in 2000, and later recertified under ISO 9001 in 2008 and 2015. PM&P has also been recognised by Superbrands five times in the past few years – most recently with a certificate for exceptional trade marks law in 2021–2022.

Authors

Mr Nikolay Cvetanov has significant experience in banking, finance and tax law, M&A and GDPR. He is head of the specialised practice groups on data protection and cybersecurity, information technology and co-chair of the practice group on banking, finance and tax law at Penkov, Markov & Partners. Mr Cvetanov has an excellent track record of lecturing at seminars, public speaking and moderating events organised by legal training centres or in partnership with a number of chambers of commerce including AmCham, GBCC, FBCC, Confindustria Bulgaria and the Bulgarian Fintech Association.

Mr Boris Lazarov is an associated partner at Penkov, Markov & Partners with experience in M&A, banking law and project finance, energy, renewable energy sources and natural resources. Mr Lazarov specialises in providing both transactional and regulatory advice to credit institutions and pension funds. He advises clients on projects for commissioning of power plants, power distribution companies and electricity trading, and also participates in and advises on complex acquisitions, project financing and securitisation, divestitures, joint ventures, corporate restructurings, mergers, spin-offs and public acquisitions.

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Penkov, Markov & Partners

Ms Anelia Licheva is an attorney-at-law and practices in the spheres of obligations and contracts law, property law and civil litigation at Penkov, Markov & Partners. She has participated in provision of legal advice on various matters, including preparation of legal opinions and documents regarding the implementation, restructuring and acquisition of commercial companies and non-profit legal entities, preparation of legal due diligence reports on business undertakings or individual assets, and drafting of various commercial agreements and real estate transactions, as well as represented clients of the law firm before court and arbitration in numerous civil, commercial and property disputes.

Mr Kristian Anadoliev is a lawyer at Penkov, Markov & Partners with significant interest in the field of EU regulations, real estate development, energy sector and environmental policy. His main focus is assisting clients on a wide range of regulatory and legal matters related to corporate governance, compliance and implementation of company policies, deal structuring, acquisition of assets and shares, project finance in a number of industries such as real estate, natural resources, energy industrial and manufacturing, and consumer goods.

Penkov, Markov & Partners

13B Tintyava Street
Floor 6
Sofia 1113
Iztok district
Bulgaria

Tel: +3592 971 39 35
Fax: +3592 971 11 91
Email: lawyers@penkov-markov.eu
Web: www.penkov-markov.eu

PM&P
PENKOV • MARKOV & PARTNERS
INTERNATIONAL LAW FIRM
SINCE 1990

Contributed by: Mr Nikolay Cvetanov, Mr Boris Lazarov, Ms Anelia Licheva and Mr Kristian Anadoliev,
Penkov, Markov & Partners

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

According to the statistics of the Bulgarian National Bank (BNB) in Q1 of 2023, the annual growth of credit to corporations continued its steady downward trend to reach 7.9% (10.4% at the end of 2022). The slowdown in the growth was influenced by both the downward dynamics of the overdraft, which fell to 12.3% (17.5% in December 2022), and weaker credit growth, excluding overdraft. The downward trend in inventories in the economy recorded since the end of 2022 resulted in weakening firms' demand for financial resources for working capital and build-up of inventories, which contributed to the lower annual overdraft growth. According to the BNB's Lending Survey data, in Q4 of 2022, interest rates had a downward impact on the demand for corporate loans, while on the supply side banks reported a tightening of credit conditions for firms in terms of both interest rates and spread, and premium for riskier loans. Volumes of newly extended loans to firms recorded a continuing upward trend over the Q1 of 2023.

Following the international trends, the investment institutions (exclusive banks), especially some international ones, have steadily increased their national footprint, further taking into consideration the growth of the national startups market, fintech ecosystem, etc. Further, increase is also evidenced in all types of investments of private equity and venture capital funds which are rarely structured and tracked as investments falling into the BNB statistics. Unfortunately in-depth, reliable statistics in this regard are missing.

Annual growth of credit to households remained high over Q1 of 2023, standing at 14.6% at the end of March (unchanged compared to December 2022). Persistently, high annual growth was retained in loans for house purchase and, to a lesser extent, consumer loans (17.8% and 12.1% respectively as of March 2023). Weak and slow transmission of increases in euro area policy rates to interest rates on new household loans in Bulgaria played a key role in sustaining high rates of credit growth to households, with rates on consumer loans remaining unchanged at historically low levels and on loans for house purchases declining in Q1 of 2023.

In real terms, taking into account annual inflation in consumer prices, the interest rates on loans for house purchase and, to a lesser extent, on consumer loans, remained strongly negative, thereby continuing to support household demand for loans. Newly extended household loans recorded a slight increase in volumes in Q1 of 2023 and a stronger rise in consumer loans.

The interest rates on new loans to corporations continued to increase gradually in Q1 of 2023. At the same time, in the household sector, lending rates on loans for house purchase remained broadly unchanged at a very low level, and those on new consumer loans registered a decline from the end of 2022. The ample liquidity and strong competition in the banking sector were the main factors behind the very limited transmission of euro area rate increases to the lending rates in Bulgaria and especially those on household loans.

1.2 Impact of the Ukraine War

Since the start of the war in Ukraine there is a certain slowdown by investors due to the rates' hikes and more expensive financing, but there is no dramatic decline on a general level. In 2022, the majority of transactions (about 60%) were made by foreign strategic investors, being a

good signal that Bulgaria is still attractive investment destination. In local and regional studies, a large number of the respondents confirmed that they were considering M&A and financing transactions in 2023. It should be noted thate investors have become much more selective regarding their transactions in the country.

1.3 The High-Yield Market

As the Bulgarian Stock Exchange (BSE) is still relatively new and modest, compared to the global economic leaders, the high-yield market has little-to-no impact on loan policies. In the last couple of years, there have been some sporadic new issuances of bonds or other financial instruments. Thus, standard financing through credit institutions retains its primary role in Bulgaria. Funds investment has been a new trend in the past one to two years.

1.4 Alternative Credit Providers

In 2018, the BSE was granted an approval by the Financial Supervision Commission of Bulgaria to set up the new SME Growth Market Beam (BM) – a special market organised by the Bulgarian Stock Exchange which allows small and medium-size enterprises in Bulgaria to become listed companies; ie, to have access to finances for their business projects through capital markets.

The main objective of the BM is to provide SMEs with an alternative to the banking finance of businesses by giving them the opportunity to raise funds within easier terms in comparison to those on the main BSE market. The BM is regarded as the first step of a company on the road towards getting listed on the main market.

The BM provides companies with a number of advantages compared to the requirements for issuers listed on the regulated market organised by the BSE. The relaxed requirements for companies are present in the admission to trading process and in their subsequent life as listed companies. The benefits include a lower requirement for capital threshold, facilitated process of accountability with rules (less reported requirements).

In July 2022, a specific regulation on the crowdfunding financing was adopted, aiming to facilitate lending and to create new and attractive instruments. Some of the largest crowdfunding platforms are entering the Bulgarian market, but considering the relatively new financing mechanism, the liquidity on these platforms remains low. This new type of financing is becoming increasingly popular, but mainly among individuals and non-professional investors.

1.5 Banking and Finance Techniques

In recent years, Bulgarian banks have produced and developed standardised documents when applying for a loan, regardless of whether they are lending to corporations or households, which follow and meet all international standards, which has set foreign investors at ease.

At the time of COVID-19, all Bulgarian banks began providing numerous online services to corporations and households, including online consultations, email exchange of highly confidential information, submission and review of documents, inspections (such as AML checks), etc. This has significantly eased the process of granting loans, especially to foreign international corporations in the country.

1.6 ESG/Sustainability-Linked Lending

Bulgarian Parliament is closely following Regulation (EU) 2019/2088 of 27 November 2019, on sustainability-related disclosures in the financial services sector and has also created various types of governmental, non-governmental and

mixed working groups aiming to timely implement the Corporate Sustainability Reporting Directive in the local legislation.

The National Ethical Standards for Advertising and Commercial Communication in Bulgaria envisage principles regarding marketing communications of environmental claims. The principles aim to facilitate honest and truthful presentation of claims in advertising. In Bulgaria, marketing communications should not contain any statement which can potentially mislead the "reasonable consumer" regarding the environmental benefits of an advertised product, or the actions implemented by the trader aimed at protecting the environment.

Pursuant to the Commercial Act, the members of the boards of joint-stock companies should comply with the "duty of care" standard – ie, to act in the best interest of the company and its shareholders, which covers, to some extent, ESG considerations.

An insignificant part of the local Bulgarian entities (those which are considered large under the Accountancy Act) are required to file a non-financial statement that should include information regarding, amongst others, environmental and social issues.

The corporations will face tougher scrutiny of how climate change affects the society/customers/consumers under new global rules aimed at helping regulators tackle exaggerated or false marketing claims about companies' climate change commitments (so-called greenwashing). The new measures were drawn up by the International Sustainability Standards Board (ISSB) as trillions of dollars flow into investments that tout their ESG credentials. Bulgaria will have to decide whether to implement these new rules and require listed companies to commit to the standards, adding that the measures could apply to annual financial statements from 2024 onwards.

2. Authorisation

2.1 Providing Financing to a Company

Pursuant to the Bulgarian Credit Institutions Act, exclusive banking activities (accepting deposits or other repayable funds from the public, accepting valuables on deposit and acting as a depository or trustee institution) could be performed by (i) local Bulgarian banks, including subsidiaries of EU and non-EU banks, licensed to operate in Bulgaria, (ii) branch offices of non-EU banks licensed to operate in Bulgaria, or (iii) EU banks which have passported their authorisation in Bulgaria.

While the license procedures of a bank and branch office follow international standards and are quite standardised worldwide, it is worth mentioning that the applicants for issuance of the relevant licence should pass very strict, detailed and formal procedures where, among others, the applicants should provide a specific set of documents and proof for the shareholders of the structure and ultimate beneficial owners, a detailed business plan, description of the management structure, proof of the skills and experience of the management members, description of the internal systems, etc. In some scenarios, the BNB should also conduct preliminary consultations with the applicants and with the supervision authorities in other EU member states before granting the respective licence. The licence of a branch office could not include activities that the bank is not entitled to carry out in its residential country.

A bank that is authorised in an EU/EEA state may conduct authorised business in Bulgaria. The bank can do this either through the provision of services or the establishment of a branch office. Based on the freedom to provide services and freedom of establishment, for activities which are mutually recognised, the bank needs a single authorisation – ie, an authorisation in the state where it is originally established. The bank must notify its home supervision authority of its intention to provide services or establish a branch in another EU/EEA state, as well as of any changes to such activities. The home supervision authority should inform the BNB about the bank's planned activities.

Non-exclusive banking activities may be carried out by banks (if included in their licence) or by other non-banking financial institutions, which deal with certain categories of non-exclusive activities. The transactions that a financial institution can carry out are payment services within the meaning of the Payment Services and Payment Systems Act, issuing and administering other means of payment (traveller's checks and letters of credit), financial leasing, guarantee transactions, trading for own account or for account of clients with foreign currency and precious metals except derivative financial instruments, provision of services and/or performance of investment services and activities, money brokerage, acquisition of credit claims and other forms of financing (factoring, forfeiting and others), issuance of electronic money.

When some transactions (financial leasing, guarantee transactions, acquisition of credit claims, factoring, forfeiting and other forms of financing, acquisition of shares in a credit institution or in another financial institution, granting of loans with funds that were not raised through public solicitation of deposits or other refundable funds) are carried out by occupation and are essential, the company should be registered as a financial institution in a special register with the BNB. The transactions are carried out "by occupation" when they are performed permanently, and not once, incidentally. They are significant when the net income from these activities or their book value exceeds 30% of the value of all net income or book value of the company. Therefore, upon reaching 31% of net income (book value) from any of the mentioned activities, the company is obliged to register as a financial institution in order to continue its activities by carrying out these transactions.

The financing could be provided by legal entities or individuals without having a licence, provided that this activity is not the main business activity of the financing party – ie, this applies to single financing operations.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

The Bulgarian law does not foresee any restrictions or other impediments for foreign lenders to provide financing in Bulgaria. However, it is not a common practice to use financing outside Bulgaria, considering the hardships in providing the relevant securities (typically assets in Bulgaria) for utilisation of the loan. Nevertheless, these techniques are often used in bridge financings, cross-border transactions, syndicate financial projects in Bulgaria, etc.

The Bulgarian Currency Act requires such foreign lending exceeding BGN50,000 to be declared before the BNB for statistical purposes.

3.2 Restrictions on Foreign Lenders Receiving Security

There are no restrictions or impediments foreseen by the Bulgarian law in providing security or guarantees to foreign lenders, excluding the UN/EU sanctions related to the war in Ukraine.

3.3 Restrictions and Controls on Foreign Currency Exchange

There are no restrictions, controls or other concerns regarding the foreign currency exchange foreseen in the Bulgarian law, excluding the UN/EU sanctions related to the war in Ukraine.

The Bulgarian AML legislation imposes certain thresholds above which a declarative regime applies and the involved parties must fill in and provide declarations and supportive documentation proving the source of income of the funds concerned.

3.4 Restrictions on the Borrower's Use of Proceeds

There are no restrictions on the borrower's use of proceeds from loans or debt securities foreseen in the Bulgarian law, other than those provided in the specific contractual obligations between the parties and those imposed by UN/EU sanctions related to the war in Ukraine.

3.5 Agent and Trust Concepts

Generally, both concepts are not recognised by the Bulgarian law. The Contracts and Obligations Act (COA), however, foresees that the parties may freely determine the content of the agreement, as long as it does not contradict with the mandatory provisions of the law and good morals. In this way, to a certain extent, the parties may agree on having a documentary escrow agent (law firm, notary public, bank, etc) which will be obliged to hold and manage the respective security. However, considering the lack of sufficient case law, these mechanics encounter many practical issues when enforcing the granted security given the fact that the law, local courts and enforcement agents do not recognise such structures.

The lack of explicit recognition of these concepts could be overcome by subordinating the contract to foreign law and court/arbitration (eg, English law), but again, the enforcement procedures in Bulgaria will pose many practical issues.

3.6 Loan Transfer Mechanisms

Pursuant to the Bulgarian COA, any receivable might be assigned, unless the assignment of such receivable is prohibited by law, or the mere agreement or the nature of the receivable does not allow it. All accessory rights are also considered automatically transferred to the new creditor (securities, interests, etc) unless otherwise agreed between the previous and the new creditor. The accessory rights, if applicable, should be also registered in the various registers by the new creditor. The previous creditor is obliged to notify the borrower of the transfer of the receivables in writing. The transfer shall be considered valid in respect of third parties and the borrower as of the date of such notification. The Consumer Credit Act (CCA) provides for an exception from the general rule, where the previous creditor informs the consumer of the transfer of the receivables, except when the previous creditor, by agreement with the new creditor, continues to administer the credit in relation to the consumer. It is worth mentioning that in both cases, the written notification of the borrower is not a precondition for the effectiveness of the assignment of the receivables.

Another possible legal structure is the transfer of the whole contractual relationship where the lenders shall be changed together with all of the

existing rights and obligations under the loan agreement.

The Bulgarian law also provides for a legal structure where a third party may step in as a co-debtor in a certain obligation by an agreement with the lender or with the debtor. If the creditor has approved the agreement for the stepping in of the co-debtor, this agreement may not be repealed or amended without his consent. The original debtor and the co-debtor shall be liable jointly and severally before the creditor for all obligations under the loan agreement and related securities.

The law also provides for substitution, where a third party may substitute the debtor only with the creditor's explicit consent. The substituted debtor shall be discharged of liability to the creditor. All securities provided by third parties shall be cancelled provided such third parties do not consent that such securities keep serving the new debtor. Pledges and mortgages provided by the original debtor shall remain in full force.

Another permitted method is the novation agreement. In this scenario, the rights and obligations under the loan agreement are considered cleared-off and at the same time the parties (whether the lender or the borrower) could be changed. These mechanics of novation are not commonly used in Bulgaria due to the fact that the security provided under the loan agreement is not directly transferred to the new lender.

3.7 Debt Buy-Back

Debt buy-back by the borrower is allowed by the Bulgarian law. Usually, lenders include some stipulations where the borrower has to pay a termination fee in case of early repayment of the loan. Where loans are provided to individuals under the CCA, arrangements for a termination fee or similar sanctions shall be considered null and void.

Last but not least, specific rules apply in cases where loans are provided pursuant to the Distance Marketing of Financial Services Act, which allows consumers to withdraw from the contract without compensation or forfeit being payable and without giving any reason, within a period of 14 days.

3.8 Public Acquisition Finance

The Bulgarian law does not recognise the concept of "certain funds" with respect to public or private acquisition transactions. Such concept, known quite well in most of EU member states, could however, be applied by the parties.

According to the provisions of the Public Offering of Securities Act, in case a transaction with shares in a listed company exceeds certain thresholds, the tender offer of the purchaser, prospectus and the appraisal of the shares performed by experts should be made available on a specific platform. The purchaser should then ensure that it possesses the necessary funds (which is to some extent similar to the "certain funds" concept) in order to pay for all outstanding company shares subject to the tender offer or squeeze-out procedure.

Depending on the magnitude of the transaction and the financing party involved (whether local Bulgarian banks, syndicate of banks, international banks) the documentation which is used might vary. In the smaller local transactions, the banks use standardised documentation for granting a loan for acquisition of the target. In larger transactions, especially when a syndicate loan is sought by the acquirer, the banks usually provide for much more documentation (which predominantly follows the London Loan Market

Association models and standards). This documentation, however, is not publicly available to any third party.

3.9 Recent Legal and Commercial Developments

Currently, there are no recent legal and commercial developments that have required changes in our legal documentation in assisting a financing transaction, except for the imposed UN/EU sanctions related to the war in Ukraine.

3.10 Usury Laws

The Bulgarian law does not provide for any rules for limitations of the amount of the interest rate/amount for the business sector. The interest over interest (anatocism) shall be due if agreed between the parties.

There are some specific restrictions in the CCA for the determination of the upper limit of the interest rate/amount.

3.11 Disclosure Requirements

There are no rules and/or laws regarding disclosure of certain financial contracts, save for the reporting obligations of public companies, banks, insurance companies and pension funds which are obliged to provide the respective regulatory authority with certain information when executing specific transactions.

The Bulgarian AML legislation imposes certain thresholds above which a declarative regime applies and the involved parties must fill in and provide declarations and supportive documentation proving the source of income of the funds concerned.

Further, the Bulgarian Currency Act requires foreign lending exceeding BGN50,000 to be declared before BNB for statistical purposes.

4. Tax

4.1 Withholding Tax

The payments of principal and interest under domestic loans are not subject to withholding tax in Bulgaria. Such payments, however, will have to be considered for the purposes of calculation of the corporate income tax of the lender.

Some specific rules might apply to cross-border loans (treaties for the avoidance of double taxation, specific requirements of the relevant tax authority where the lender/borrower has tax residency).

4.2 Other Taxes, Duties, Charges or Tax Considerations

Local companies are subject to corporate tax on their worldwide income and capital gains. Foreign companies incorporated outside Bulgaria, but carrying out business activities in Bulgaria, are liable to tax on income arising in Bulgaria.

In Bulgaria, transactions with financial instruments are exempt from VAT. In some cases, state charges and notary fees might apply in case of providing a mortgage as security under the loan agreement. Real pledges, special pledges and other types of security should not trigger stamp duties.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

There are no such tax concerns.

5. Guarantees and Security

5.1 Assets and Forms of Security

In terms of lending and/or M&A transactions in Bulgaria, the most commonly used security packages include pledge over shares, non-pos-

sessory pledge over the whole or part of the going concern (commercial enterprise) of the target company, and non-possessory special pledge over specific assets or bank accounts of the target company.

Depending on the type of company, there are different rules which should be observed in pledging the quota or shares of the companies. The pledge over quotas (equity stakes) in the Bulgarian form of a limited liability company should be executed by a written agreement in notarial form and should be also registered with the Commercial Register. The materialised shares in a joint-stock company are pledged by i) endorsement for pledge on the reverse side of the share certificate (most commonly on the reverse side on the interim certificate due to the rather slow and complicated procedure for issuing physical shares) or on the alonge to the share certificate, and ii) delivery of the shares. The share pledge should be also entered into the shareholders' book for opposability against third parties. The pledge over dematerialised shares should be executed by a written agreement in notarial form and registered with the Central Depository. In Bulgaria, pledges over shares or quotas (equity stakes) are always combined with special pledge over receivables of the shares from dividends and liquidation quota. These special pledge agreements should be concluded in a simple written form and registered with the Central Register of Special Pledges (CRSP).

The special pledge over the whole or part of the going concern (commercial enterprise) of a company is another often-used instrument in large transactions in Bulgaria. As a legal structure, the pledge over the whole going concern of a company includes all rights, obligations and pool of factual relations. The pledge should be executed by a written agreement in notarial form and should be also registered in the Commercial Register together with all necessary written consents and other accompanying documents. Depending on the assets of the company, further secondary registration of the respective asset should be performed in the relevant register (eg, for real estate – the Property Register (PR), for trade marks – the Patent Office, for movables – the CRSP, etc). Naturally, as a security under the Bulgarian law, a standalone mortgage over real estate might be established. In practice, considering the relatively high costs for establishment of such collateral, borrowers prefer to provide a security pledge over the going concern or part of it, thus also involving the real estate as part of the assets.

Another standard security in Bulgaria is the special pledge over receivables. This pledge presupposes signing of an agreement in simple written form, registration in the CRSP and notification of the debtor under the pledged receivables. The pledge agreement should specify in detail the receivables subject to the pledge. The financial collateral pledge is also part of the security package in terms of financing projects. Typically, this type of security is provided to the lender (bank or financial institution) by the borrower by means of agreement in simple written form.

5.2 Floating Charges and/or Similar Security Interests

In Bulgaria, the concept of floating charge is, to some extent, recognised in the special pledge over the whole or part of going concern, where a pool of rights, obligations and factual relations (including all present and future assets of the company) is provided as a security.

5.3 Downstream, Upstream and Cross-Stream Guarantees

Companies in Bulgaria can give downstream, upstream and cross-stream guarantees. These company guarantees are well known and widely used within the terms of various transactions. There are some restrictions, however, in issuing an upstream guarantee.

There is one criterion that should be observed, namely, the management of the company is obliged to act in good faith and in accordance with the law, the stipulations of the articles of association, and in the best interest of the company. Thus, when issuing one of the discussed guarantees, the management of the company should take into account the best interest and related benefits of the company.

5.4 Restrictions on the Target

The prohibition on financial aid is applicable only to joint-stock companies. The joint stock company could not grant any loans or guarantees for the acquisition of its shares by a third party. Such restriction does not apply to transactions concluded by banks or financial institutions in the ordinary course of their business, if some specific requirements are met. There are no such restrictions on the other commonly used form of legal entity in Bulgaria – the limited liability company.

5.5 Other Restrictions

There are no significant costs associated with the grant of security or guarantees for loan agreements. No specific prior authorisation or consent by a work council or similar body is required.

5.6 Release of Typical Forms of Security

Depending on the type of the security provided, there are different formalities to be met in releasing the respective security. Generally, the securities are typically ancillary to the secured obligations and thus they are considered as automatically terminated upon full repayment of secured obligations. In such cases, there are no specific formal requirements to release the security. In practice, however, the market standards have imposed the requirement of specific confirmations (pay-off letters, repayment agreements, etc) on the full repayment, in addition to the legally required documentation. In other cases of non-possessory securities, there are different requirements for release of the provided security. Naturally, when the relevant pledges are registered in the local Bulgarian registers, there are formal requirements for their release/deletion, such as written consent in notarial form accompanied by other necessary documents which have to be submitted for purpose of the deletion. Usually, the parties submit all such documents under documentary escrow agreement to the chosen escrow agent (typically law firm, notary public or bank).

5.7 Rules Governing the Priority of Competing Security Interests

The Bulgarian law follows the principle first come, first served, based on the date of establishment and registration, if necessary, of the security, unless registration procedure is completed and priming liens are established, as specified in **5.8 Priming Liens**.

Loan subordination agreements are common in private project financings. Breach of the debtor's obligation under such an agreement usually qualifies as an event of default and can lead to acceleration of the debt. However, such agreements are not enforceable in a bankruptcy procedure, where the ranking of the various types of creditors is determined by mandatory legal provisions.

Intercreditor agreements are also used. However, such agreements are not enforceable in a bankruptcy procedure, where the ranking of the various types of creditors is determined by mandatory legal provisions.

5.8 Priming Liens

Pursuant to the COA (Article 136), claims secured by a pledge or mortgage (satisfied out of the value of the pledged or mortgaged property) are among the listed claims that shall be satisfied preferentially.

Regarding security by operation of law, Article 60, paragraph 4 of the Credit Institutions Act provides for the right of a creditor (which has the capacity of a credit institution) to establish a mortgage by operation of law on the immovable property which has been acquired in whole or in part against the funds subject to the bank loan.

Such a mortgage shall be established by a unilateral statement on behalf of the bank, which shall bear notarised signatures of the bank's legal representatives and shall be registered with the PR. The characteristics and the legal effects of a mortgage by operation of law are identical to those of a contractual mortgage.

In order for the mortgage by operation of law to be valid, the application for its registration shall specify the identity of the creditor, the identity of the owner, the identity of the debtor, the property that is serving as a collateral and the amount and legal ground of the secured receivable.

The receivables of creditors having mortgages established in their favour are satisfied in the order of their entry in the PR, meaning that the first (earliest) registered mortgage has priority, and only after the receivables it secures are satisfied, may it proceed with the satisfaction of the receivables secured with mortgages entered thereafter.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Secured loans may be enforced in the event of default of the debtor, most typically in the form of delay in payment of the instalments in accordance with the repayment schedule, or other breach of contractual obligation, as provided in the contract.

Depending on the type and the subject of the collateral, the Bulgarian legislation provides for different methods and procedures of enforcement, which may or may not include a before-the-court phase.

Under the Bulgarian legislation, any clauses for direct out-of-court enforceability of the loan, even if the agreement bears notarised signatures, are not directly enforceable.

Enforcement of Mortgages and Pledges

If the loan is secured with a mortgage or a pledge, the lender will need to obtain a proper enforcement title and a writ of execution, in order to initiate an enforcement procedure. The enforcement of such collateral is always conducted by an enforcement agent.

The Civil Procedural Code (CPC) governs order for payment proceedings, which is a simplified and faster procedure for obtaining a payment order and a writ of execution, where the payment order substitutes the final and enforceable court ruling as an enforcement title, and allows the lender to start enforcing its receivables before such ruling takes place. Within that procedure,

the order for payment proceedings and the writ of execution are issued based on certain documents, the following of which are widely used in enforcement of secured loans:

- excerpt of the books of account of a bank accompanied by the document from which the receivable has arisen (the loan contract), along with the annexes thereto, and the applicable general conditions, if any;
- a notarial deed or another contract bearing notarised signatures; and
- a contract of pledge or a mortgage deed.

The order for payment proceedings is initiated by the lender and unfolds before the relevant court. The court conducts simplified revision of the documents and if they meet the legal requirements the court issues a payment order and the writ of execution. Upon obtaining the writ of execution the lender may immediately initiate an enforcement procedure. The debtor is notified of the procedure upon receiving an invitation for voluntary payment by the enforcement agent. If the debtor objects to the obligation, the lender will have to bring its claims before court, but the enforcement procedure will develop along with the court case. The enforcement procedure initiated in this manner may be suspended under certain conditions provided for in the CPC.

Enforcement of Special (Non-possessory) Pledge

The special pledge as a form of collateral is governed by the Special Pledges Act. The contract establishing the special pledge shall be registered with the CRSP or the relevant register depending on the subject of collateral. It may be enforced with or without the assistance of an enforcement agent upon decision of the lender. The enforcement of this type of collateral is not predisposed by obtaining a writ of execution by court, however, the following conditions have to be met: (i) the lender needs to enter into the CRSP a commencement of the enforcement regarding the pledged assets; and (ii) the lender needs to notify the debtor of the commencement of the enforcement. If the subject of the pledge is certain receivables of the debtor from third parties, the lender has to also notify them. The enforcement procedure may commence at the request of the lender on the basis of an excerpt from the respective register ascertaining the registered commencement of the enforcement regarding the relevant pledged assets. If the lender decides to enforce the collateral without the assistance of an enforcement agent, the lender shall appoint a depositary who shall collect the proceeds received as a result of the enforcement in a special bank account opened for this purpose, and will make a distribution of the funds.

The enforcement of special pledge may develop along with the court case on the debt.

6.2 Foreign Law and Jurisdiction

Being an EU member state, Regulation (EU) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I) shall apply as part of the internal state legislation of Bulgaria. Pursuant to the Rome I Regulation the parties are entitled to make a valid choice of foreign law to govern their contractual relations and such choice will, in general, be upheld by the Bulgarian courts. However, there are certain exceptions, such as if the foreign law provisions contradict substantial Bulgarian policy rules, the court may not uphold the parties' choice and may not apply the relevant foreign rule. Also, the Bulgarian courts will apply the Bulgarian law provisions which are considered to be of significant importance for the public interests of Bulgaria.

Contractual provisions for submission by a Bulgarian party to a foreign court are also valid, as far as they concern matters that are not outside the competence of the Bulgarian courts.

Waiver of immunity clauses are also generally valid and are upheld by Bulgarian courts. The rule is that all assets owned by the debtor are enforceable. If the debtor is a natural person, there are some restrictions for enforcement over some assets and income up to a certain amount specifically listed in the CPC. However, if the debtor voluntarily gives some of those assets as collateral, the aforesaid restrictions shall be considered to have been waived by the debtor with respect to these assets.

6.3 Foreign Court Judgments

Foreign court judgments are enforceable in Bulgaria without the necessity of revision of the merits of the case by the competent authority, however there are different procedures provided for recognition and enforceability depending on whether the judgment or award subject to enforcement is issued by court of an EU state or non-EU state.

With respect to court judgments issued by a court of an EU member state, 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) shall apply, meaning that such court judgments shall be enforceable without re-examination or re-litigation of the matters already adjudicated.

On the other hand, the procedure for recognition and admission of enforcement of a court judgment issued by a court of a non-EU state is governed by the Bulgarian Private International Law Code. Although the code expressly provides that the competent authority does not decide on the merits of the case, in this procedure the debtor has the right to invoke objections based on facts that occurred after the decision was issued, such as an expired statute of limitations term. The authority has the right to rule on these objections and if it decides to uphold them, it may refuse to allow the enforcement of the judgment. The same regime shall apply to arbitral awards originating from a non-EU state.

6.4 A Foreign Lender's Ability to Enforce Its Rights

Under the Bulgarian law, any documents presented in court proceedings need to be accompanied by a translation in Bulgarian language. It is not mandatory for the translation to be made by a certified translator, however if the other party objects to the translation, the court will oblige the party, which initially presented the relevant documents, to present a new translation made by a certified translator.

There are also certain specifics in enforcement of consumer loans, where debtors are granted enhanced protection. The court is obliged to check ex officio for the existence of unfair terms in a contract concluded with a consumer. If the court detects such clause, it may deny the issue of a payment order and writ of execution. If, after the issuance of such order and writ of execution, the court receives an objection by the consumer that the receivable originates from an unfair clause the court may suspend the enforcement of the loan until a final enforceable ruling in favour of the lender takes place.

Last but not least, arbitration procedures against consumers may not be initiated by the lenders and all such disputes might be only addressed for resolution by the state courts.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

Upon filing the application for opening of an insolvency procedure the statute of limitation term regarding the receivable, which served as grounds for the application, ceases, and the statute of limitations term does not run while the insolvency procedure is pending. However, the main consequences of the insolvency procedure are related not to the opening of the procedure, but to the issuance of a court decision whereby the debtor is declared insolvent. Upon such decision the following occurs.

- All of the debtor's obligations become immediately due. All of the non-monetary obligations of the debtor are transformed into monetary obligations.
- A secured lender preserves its rights on the collateral.
- The court specifies the initial date on which the debtor has become insolvent. This date is of great importance for the possibility for some transactions concluded by the debtor before the opening of the bankruptcy proceedings to be cancelled and some assets that the debtor disposed of to be returned to the bankruptcy estate.
- The court imposes precautionary measures over the entire property of the debtor.
- The court appoints a trustee of insolvency to supervise the activity of the debtor and to manage the bankruptcy estate. The bankruptcy estate is formed by all of the debtor's assets available at the time of opening the insolvency procedure. Some assets that have been passed by the debtor after the initial date of insolvency, or within a certain period prior to that date, may be returned and included in the bankruptcy estate upon successful claims initiated by the trustee of insolvency. Upon declaring the debtor insolvent, any new commercial contracts and deals may be concluded only upon permission of the trustee of insolvency and in line with the precautionary measures imposed on the debtor's property. However, if the court decides that there is a risk that the debtor will dispose of its property, the court may deprive the management bodies of the debtor of their right to manage and represent the debtor, and order that the debtor shall be managed and represented solely by the trustee of insolvency.
- All creditors are obliged to claim their receivables before the bankruptcy court within an overall period of three months as of announcement in the Commercial Register of the court decision for opening bankruptcy proceedings. The statute of limitation regarding each receivable ceases upon claiming the receivable before the insolvency court.
- Any receivables that remain unclaimed and any rights that remain unexercised within the course of the bankruptcy proceedings are deemed to be extinguished.

Upon opening of bankruptcy proceedings, any pending judicial and arbitration proceedings in property, civil and commercial cases against the debtor are suspended, with certain exceptions provided for in the law. Initiating any new judicial or arbitration proceedings in property civil or commercial cases against the debtor is inadmissible after the opening of bankruptcy proceedings, except for protection of the rights of the third parties who are the owners of movables or real property included in the bankruptcy estate, labour disputes, and monetary claims secured by the property of third parties.

7.2 Waterfall of Payments

Pursuant to the Commerce Act (CA), the creditors of the insolvent debtor are classified in several ranks, as their claims are satisfied from the amounts received from liquidation of the bankruptcy estate, in the following sequence:

- receivables secured by a pledge, mortgage, lien or foreclosure, entered in accordance with the Special Pledges Act – from the amount received upon realisation of the relevant specific collateral;
- receivables for which the right of retention is exercised – from the value of the relevant property;
- bankruptcy costs;
- receivables arising from employment relationships that arose prior to the date of the decision to open bankruptcy proceedings;
- alimony payable by law by the debtor to third parties;
- public receivables of the state and municipalities, such as taxes, duties, fees, mandatory insurance contributions and others, which arose before the date of the decision to open bankruptcy proceedings;
- receivables that arose after the date of the decision to open bankruptcy proceedings and are unpaid on maturity;
- the remaining unsecured claims that arose before the date of the decision to open bankruptcy proceedings;
- claims for legal or contractual interest on an unsecured claim due after the date of the decision to open bankruptcy proceedings;
- claims for credit granted to the debtor by a partner or shareholder;
- receivables under a gratuitous transaction; and
- the expenses of the creditors in connection with their participation in the bankruptcy proceedings, with certain exceptions.

When the funds are insufficient to fully satisfy all the claims, they are distributed proportionally among the creditors included in the relevant rank of order.

7.3 Length of Insolvency Process and Recoveries

Usually, the insolvency procedure is time consuming and may take anywhere between a year-and-a-half and several years, meaning that the eventual satisfaction of the lender's receivables is often significantly delayed. Satisfaction in full of all claims is rarely reached, however, pursuant to the CA, the secured lenders are classified as first rank creditors and are satisfied by privilege from the amounts accumulated from enforcement of the relevant collaterals. This makes their chances to collect a significant part, or even all of their outstanding receivables considerably better than the other ranks of non-secured creditors. The secured lenders also participate in the distribution of amounts accumulated from the enforcement over the assets included in the insolvency estate, other than the collaterals, ensuring their receivables, but as unsecured creditors of the rank of remaining unsecured claims that arose before the date of the decision to open bankruptcy proceedings.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

The CA provides for the following procedures for preventing the debtor from becoming insolvent or if the insolvency is already a matter of fact, for recovery of the debtor and overcoming the bankruptcy.

Restructuring Proceedings (RP)

Effective as of 1 July 2017, the CA provides for RP for merchants who are not bankrupt, but are in imminent danger of bankruptcy. The procedure aims to avoid the bankruptcy. It starts vol-

untarily upon the debtor's application to the relevant court. Along with the initiating application, the debtor is required to present certain documents on its activity and financial state, including a restructuring plan containing suggestions on restructuring the business of the debtor, and the manner, terms and conditions for repayment of its liabilities. The debtor also provides a list of all of its creditors, including those in favour of which the debtor has established collaterals in order to guarantee a third party's liabilities. The list contains detailed information about the debtor's obligations, and the collaterals granted. The debtor shall apply market evaluation of the non-monetary obligations. The main legal effects of the proceedings are as follows.

- Upon opening the RP, all pending enforcement proceedings against the debtor are suspended, as is the initiation of new enforcement proceedings (EP), and the entering a commencement of the enforcement in the CRSP pursuant to the Special Pledges Act, is prohibited. An exception is a new EP regarding claims of workers and employees of the debtor.
- Upon opening of the RP, the limitation term for all obligations of the debtor is considered suspended.
- As of the initiation of the RP, the merchant may not make any payments on any outstanding payables, arising prior to the date of initiation, except for public receivables such as taxes or mandatory social security contributions on behalf of its workers or employees.
- All of the non-monetary obligations are transformed into monetary obligations.
- The commercial activity of the debtor is placed under the supervision of an appointed-by-court trustee. If there is a risk to the creditors' interests, the court may restrict or suspend the merchant's right to manage and dispose of its property, and grant this right to the trustee.
- The restructuring plan endorsed by the court is binding for the debtor and the creditors having receivables arising prior to the date of the decision to endorse the plan. The plan shall have no effect for any creditor, who has not been included in the list of creditors or has not been provided with the opportunity to vote for the acceptance of the plan. All receivables included in the restructuring plan shall be transformed as provided for in the plan.
- Any creditor, who has not received full or partial performance in accordance with the plan is entitled to enforce its receivable. In this case the transformative effect of the plan with regard to the rights of such creditor shall be retroactively cancelled and the creditor may collect the outstanding part of its receivable.

Administration of the Enterprise Proceedings

The aim of this procedure is to give the debtor the opportunity to overcome the state of insolvency and to avoid termination of its activity and its deregistration as an entity. The proceedings may be initiated by the debtor, the trustee of insolvency, certain groups of creditors, certain groups of shareholders or 20% of the employees of the debtor, by suggesting an administration plan, containing suggestions for deferral or rescheduling of payments, partial or full discharge of the payables, reorganisation of the enterprise of the debtor, or reorganisation of the performance of other actions or transactions. Such plan may be proposed within a one-month term as of the announcement of the court resolution for approval of the final list of the creditors in the procedure of insolvency and may provide for establishment of supervision authority on the

activity of the debtor. The main legal effects of these proceedings are as follows.

- The approval of the administration plan of the court terminates the insolvency procedure and establishes the supervision authority, proposed with the plan.
- Upon final approval of the plan the receivables of the creditors are finally transformed in accordance with its provisions.

If the debtor does not fulfil its obligations under the plan, the creditors whose receivables have been transformed with the plan and who represent not less than 15% of the total amount of claims against the debtor, or the supervisory authority, may request the reopening of the bankruptcy proceedings without necessity of proving that the debtor is insolvent or overindebted.

Undertaking another recovery procedure is permitted.

7.5 Risk Areas for Lenders

The most significant risks for the lenders arising from the possible insolvency of the debtor or the guarantee provider are:

- if the insolvent debtor does not have enough assets to even cover the cost of commencement of the insolvency proceeding, the latter will be suspended. If, within one year of the suspension, none of the creditors of the insolvent debtor pays the costs necessary for the proceedings to commence, the proceedings will be discontinued;
- if a lender misses the term to bring its claim before the insolvency court the lender may lose it as it shall be considered extinguished; and
- the eventual satisfaction of the lender's claims is always at risk of being delayed and rarely repaid in full.

8. Project Finance

8.1 Recent Project Finance Activity

A specific set of rules in relation to project finance does not exist, and the field is regulated by the general provisions of the Bulgarian and the EU law.

Project finance is primarily used for funding private projects in the field of renewable energy (mostly photovoltaic power plants) and commercial/residential real estate. Funds are provided by banks in the form of long-term, debt-financing special purpose vehicles (SPV) owning the assets provided as collateral. The financial self-participation of the investor versus the bank financing is usually at 40:60 or 30:70 ratios. The public infrastructure is predominantly funded by the state via EU funds, EU institutions, inclusive EBRD, and through public procurement road and railroad construction to a lesser extent, government concessions in regard to resource extraction, airport and port operation management, utilities and municipal transportation.

8.2 Public-Private Partnership Transactions

In 2013 the Public-Private Partnership Act (the "PPP Act") came into force, providing special rules for PPP transactions in Bulgaria and making a clear distinction between a PPP and a concession. In 2018, the PPP Act was revoked and replaced by the Concessions Act (CA) in line with the concession's legislation at EU level (Directive EU/23/2014). As of 2018, the concession is defined as a "PPP whereupon an economic operator executes works or provides services

awarded by a contracting authority and/or by a contracting entity by way of a works concession or a services concession", putting a mark of similarity between concessions and PPP.

The CA distinguishes three types of concessions (PPP).

- Construction concession – previewed for the construction of public asset(s), through which the public service shall be delivered.
- Service concession – envisages the provision, operation and management of one or more public services (other than construction) by a private partner.
- Sectoral concession – a newly introduced form, constituting the award to a private partner to carry out a particular economic activity related to the supply and operation of fixed networks for natural gas, heating, electricity, or the provision of a service to the public in the field of transport and postal services, exploitation of geographical area for the purpose of extracting oil or gas and exploring for, or extracting, coal or other fossil fuels as well as the provision of airports and maritime or inland ports or other terminal facilities.

PPP/concessions transactions may be carried out as a contract between the public partner and the private partner, via SPV set up specifically for the implementation of the project or as an institutionalised PPP, where the ownership of the company carrying out the project is shared between the public and the private entities.

Based on the contracting authority, the CA previews state concessions (in this case the authority is the Council of Ministers; the approval of the Parliament is required in case of provision of state guarantees) and municipal concessions (where the authority is the Municipal Council).

Under the Bulgarian law, the operational risk is transferred to the private partner, however, the private partner disposes of the right to collect revenues from the provided public service. Depending on the specific public assets or services awarded through PPP, other sector-specific legislation may apply.

8.3 Governing Law

In case of funding a private project, the Bulgarian authorities and courts would recognise a choice of a foreign law clause in the contract. Nevertheless, the court will apply mandatory rules under the Bulgarian law and the public order provisions.

In respect to the Bulgarian International Private Law Code and the relevant EU regulations, there are no obstacles for the parties to choose a foreign jurisdiction, except in the case of disputes related to immovable property, in which the principle of the "law of the place where the property is situated" applies (lex loci rei sitae). Subsequently, the Bulgarian law will apply in cases of enforcement of real estate collaterals (mortgage/special pledges).

In projects finance, where public authorities are the contracting party, the law does not explicitly mandate the choice of law, as the parties have the freedom to choose it. Nevertheless, in the implementation of regulated activities (construction, natural resources, energy, etc), the relevant mandatory provisions of the Bulgarian legislation must be observed and applied.

8.4 Foreign Ownership

There is a clear distinction regarding property rights if the foreign individual or foreign legal entity has its domicile/seat in an EU/EEA state, or a third country.

All foreign citizens and foreign legal entities may acquire ownership rights and limited real rights over buildings (both residential and commercial) as well as limited real rights over land plots (right of superficies, servitude rights, etc) and land plots serving as accessory property for a building.

Regarding acquisition of land plots and in respect of the Treaty of Accession of Bulgaria to the EU, EU/EEA citizens and legal entities can acquire non-agricultural land plots without restrictions. To be able to acquire agricultural land plots, EU/EAA citizens must reside on the territory of Bulgaria for at least five years prior to the acquisition transaction.

Third-country nationals could acquire land exceptionally on the basis of an international treaty ratified and entered into force. At the time of writing, no such treaty has been signed between Bulgaria and another country. In addition, there is an explicit prohibition for non-EU/EEA citizens and Bulgarian companies, owned by third-country nationals, to acquire or own agricultural land plots. If a person, who does not meet the requirements to own certain land plot, inherits one, that same person is obliged to sell it to another eligible one, within three years of the succession.

8.5 Structuring Deals

The main points, which might be a prerequisite for structuring a project finance transaction, include the following.

- The financial structure of the deal regarding the financing of the project – ie, especially if funds provided by the bank/financial institution involve debt financing, equity financing or debt/equity financing. If the latter two are involved the bank will be directly involved in the implementation of the project, which might complicate the deal.
- Essence of the deal – depending on whether the deal is a transfer of shares or acquisition of a real estate asset (transfer of in rem rights) the latter will require the general rules regarding property and ownership rights in Bulgaria to be applied.
- Administrative burden related to the issue of complex permits – big, complex projects might presuppose granting approvals from several authorities on a national and local level (in different fields).
- General social and political risks, most notably issues related to the protection of environment – specific for Bulgaria in recent years has been the organisation of local referendums on granting of concessions and exploitation of natural resources and the implementation of large infrastructure and energy projects.
- General risk from an economical and financial point of view – for example, default/bankruptcy of the debtor, or abrupt change in the economic conditions.

The long-term policy of the authorities is to continue to encourage foreign investments in Bulgaria. In 2022, foreign direct investments (FDI) grew by 50% year-on-year. In respect to the national and EU rules, a general distinction between EU and non-EU investors exists. Taking into account that Bulgaria is a part of the EU and part of the European Single Market, FDI from other EU member states is considered to be facilitated by the principle of free movement of goods, capitals, services and persons.

Two forms of legal entities are usually used for project companies in Bulgaria – OOD (limited liability company) or AD (joint-stock company). Both provide limited liability of the sharehold-

ers to the amount of their monetary or in-kind contribution. In respect of company governance, an OOD can have one or more managing directors, assigned with the day-to-day management, while an AD could have a one-tier system (board of directors) or two-tier system (management board and supervisory board). AD has more flexible rules for the transfer of shares, as the OOD would require the acceptance of a new shareholder by the general meeting of the company.

8.6 Common Financing Sources and Typical Structures

The most common source of financing is debt equity financing by banks or by private equity funds. Some local, large-scale projects are being financed by EU funds, European Investment Bank, EBRD and the Bulgarian Bank for Reconstruction and Development. In some cases bond issues are used.

8.7 Natural Resources

Natural resources are the exclusive property of the state. The state exercises sovereign rights to the continental shelf (coastline) and within the exclusive economic zone, the exploration, development, exploitation, protection and management of biological, mineral, and energy resources of maritime spaces.

The state can award concessions for these items and can grant authorisations for the performance of activities where these are specified and regulated by law (for example, the subsurface resources extraction concession can be granted under the terms of the Subsurface Resources Act).

There is no legal restriction on a foreign company participating in a concession procedure. Still, specific licences and authorisations might be required.

8.8 Environmental, Health and Safety Laws

The main environmental, health and safety rules are issued on a national level in respect to the particular EU directives, recommendations and sustainability targets. The respective national and local authorities oversee and control the implementation of the rules.

The following legislative acts regulate different aspects of environmental, health and safety-related activities:

- Environmental Protection Act;
- Liability for Prevention and Remedying of Environmental Damage Act;
- Climate Change Mitigation Act;
- Biodiversity Act;
- Water Act;
- Clean Ambient Air Act;
- Soils Act;
- Waste Management Act; and
- Safe Use of Nuclear Energy Act.

The Ministry of Environment and Water is the main actor regarding environment, health and safety laws as it develops and implements the state environmental policy, including preparation of legislative acts (legislative initiative), strategic planning – elaboration of national plans and strategies, as well as implementation of sector policies – water, waste, climate, air, etc – regulatory and control functions for prevention of pollution of the environment.

CAMEROON

Law and Practice

Contributed by:
Aurélie Chazai, Paul Ariel Kombou, Yann Solle and Thierry Henri Ngombono
Chazai Wamba

Contents

Chazai Wamba (formerly Chazai & Partners) is a business law firm with a focus on Africa. Founded in 2017, the firm now has a team of 20 lawyers (admitted to the Cameroon, Paris and Nigerian Bars) and legal advisers, the firm is active in all areas of business law and has a well-regarded banking and finance practice. The firm is based in Douala (Cameroon). It also has an office in Paris (France) and a presence in the cities of Port-Gentil and Libreville (Gabon).

The firm's recent banking and finance work includes the structuring and/or negotiation of a USD244.65 million syndicated loan to GSEZ for the construction, maintenance and operation of the Libreville international airport; a USD164.63 million syndicated loan to the Port Authority of Douala; a EUR50 million loan from the IFC to BOCOM Petroleum; and a USD15 million syndicated loan to CFAO Retail.

Authors

Aurélie Chazai is a lawyer admitted to the Cameroon and Paris Bars and the managing partner at Chazai Wamba. Prior to this, she was an associate in the Paris offices of Cleary Gottlieb Steen & Hamilton LLP, and Ashurst LLP. With 15+ years of experience, she specialises in banking and finance and capital markets. In 2022, she was involved in more than USD1 billion worth of financing deals. She holds MAs in Financial Law, Business and Tax Law, and a BA in Private Law all from the Université Paris I – Panthéon Sorbonne.

Paul Ariel Kombou is a lawyer admitted to the Cameroon and Nigerian Bars, and a senior associate at Chazai Wamba. He has five years of experience in the legal field and specialises in banking and finance and banking regulations. In 2022, he was involved in more than USD270 million worth of financing deals. Paul Ariel Kombou holds an MA in Business Litigation and Arbitration from the Catholic University of Central Africa (Yaoundé) and a Bachelor of Laws from the University of Buea.

Yann Solle is a senior associate at Chazai Wamba. He has ten years of experience in the legal field and specialises in project finance, M&A and public-private partnerships. In 2022, he was involved in around USD120 million worth of financing deals. Yann Solle holds MAs in Public Law and Public International Law from the Université Paris II – Panthéon Assas, and a BA in Private Law from the Private University of Tunis.

Thierry Henri Ngombono is a junior associate at Chazai Wamba. He has two years of experience in the legal field and specialises in banking regulations and digital law. In 2022, he was involved in more than USD80 million worth of financing deals. Thierry Henri Ngombono holds an MA in Business Litigation and Arbitration and a Bachelor of Laws from the Catholic University of Central Africa (Yaoundé).

Chazai Wamba

Boulevard de la République
Immeuble CEDAM (4th Floor)
Bali
P.O. Box 4937 Douala
Cameroon

Tel: +237 233 43 26 17
Email: contact@chazai-wamba.com
Web: www.chazai-wamba.com

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Recent economic cycles and regulations are key drivers in Cameroon's loan market. Banking regulation is pivotal and is governed by laws and institutions both nationally and within the community, such as the Bank of Central African States (BEAC), the Central African Banking Commission (COBAC), and the Central African Economic and Monetary Community (CEMAC).

Economic Impact

Real GDP growth fell slightly to 3.4% in 2022, down from 3.6% in 2021, primarily due to sustained investment and non-oil activities. Inflation rose sharply to 6.2% in 2022, surpassing the CEMAC target of 3%.

Despite a 2020 recession owing to COVID-19 countermeasures, the economy bounced back with 3.4% growth in 2021.

Regulatory Landscape

Notable national laws include Law No 2022/006, addressing banking secrecy, and Law No 2019/021, regulating credit activities in banking and microfinance.

Community rules also apply, particularly in crisis management of credit institutions, anti-money laundering, and foreign exchange regulation.

Market Trends

Financial institutions can publicly raise funds, provide loans, and offer other services, subject to approval.

With 13 operational banks holding assets of approximately XAF1,700 billion (approximately USD3 billion), Cameroon's banking system demonstrated resilience even during the 2008-2009 financial crisis.

1.2 Impact of the Ukraine War

The Ukraine conflict has had far-reaching economic consequences globally, with notable repercussions on Cameroon's loan market.

- Inflation: The war has exacerbated inflation, affecting both global and local markets, and eroding household purchasing power.
- Trade: Cameroon's significant trade with Russia and Ukraine could be disrupted, potentially driving up import costs.
- Export relations: The increasing exports from Ukraine to Cameroon are at risk, affecting

foreign exchange rates and potentially the loan market.
- African impact: While the exact impact on African nations like Cameroon is not yet quantified, the war could have a domino effect on financial markets across the continent.

1.3 The High-Yield Market

The high-yield market in Cameroon plays a crucial role in financing, yet it remains underresearched. Several factors hint at its evolving landscape:

- Bond market: Recent expansion has diversified offerings, from domestic bonds with three-month to five-year tenures to a ten-year Eurobond. This variety may influence the high-yield market's financing terms.
- Macroeconomic factors: A slight decrease in GDP growth in 2022 and rising inflation beyond CEMAC targets could affect the high-yield and broader loan markets.
- EIB financing: The European Investment Bank committed EUR27 million for long-term investments in Cameroon, possibly affecting the high-yield market by altering financing terms to accommodate this influx.

1.4 Alternative Credit Providers

Alternative credit providers like MFIs and microcredit agencies have gained prominence in Cameroon, affecting financing terms and structures:

- MFIs: Emerging as key financiers for underserved communities, MFIs in Cameroon meet African benchmarks, albeit with a possible trade-off between performance and outreach.
- Microcredit for SMEs: Proparco signed a financing agreement with Cameroon Private Enterprise Credit Agency, providing a loan of XAF2 billion to bolster microcredit for SMEs.
- Digital expansion: A growth in the microfinance sector is anticipated due to the increased adoption of mobile money and micro-insurance.
- Credit accessibility: Efforts to ease credit access are likely to positively impact financing terms and structures, though specifics are lacking.
- Credit provision: BEAC reported increased credit provision in Q1 2020 compared to the previous year, which may influence financing terms.

1.5 Banking and Finance Techniques

Cameroon's banking and finance sector is adapting to meet the demands of a diversifying investor base and borrower needs. Key trends are outlined below:

- HoldCo structures are increasingly being used for efficient asset management and investment consolidation.
- Preferred equity appeals to conservative investors with dividend preference and higher liquidation claims.
- Digitalisation is improving access to banking services, including in remote areas.
- Microfinance lending is a viable alternative for borrowers not meeting traditional criteria.
- Regulatory changes are being made to safeguard investors and borrowers, including enhanced risk disclosure and capital requirements.
- There is an increase in customised bonds and derivatives for specific needs.
- Policies like tax breaks are designed to encourage FDI.
- Ethical/sustainable finance, aligned with global and local sustainability goals, is on the rise.
- Initiatives are underway to improve informed participation in the sector.

1.6 ESG/Sustainability-Linked Lending

The rise in ESG and sustainability-linked lending reflects a global trend, driven by regulatory shifts and stakeholder pressures. In Cameroon, while direct data on ESG lending is limited, key developments indicate a move toward sustainable finance.

Climate-Action Investments

World Bank studies propose that poverty in Cameroon could be significantly reduced by 2050 through climate-action reforms.

Green Growth

The African Development Bank (AfDB) suggests leveraging natural resources to fund green initiatives in Cameroon.

Alternative Financing

A UNDP forum emphasised the role of sustainable finance in Cameroon's economic agenda.

Green Bonds

Such bonds are recognised as a viable method for funding green projects, potentially laying the groundwork for sustainability-linked lending in Cameroon.

Project Funding

AfDB has financed sustainable urban sanitation and port development, indicating a shift toward green project finance.

2. Authorisation

2.1 Providing Financing to a Company

In Cameroon, entities wishing to offer financial services to companies must abide by regulatory requirements. These requirements differ for banks and non-banks, as summarised below.

Requirements for Banks

Credit institution license

Banks in the CEMAC zone must procure a unified license, facilitating cross-border operations.

Corporate structure

Banks must be established as public limited companies with board governance.

Shareholder information

Detailed data, including shareholding distribution and notarised declarations, must be provided.

Management profiles

Necessary personal and professional details of directors and officers must be submitted.

Procedures for Banks

Application

The bank must first draft an authorisation request.

MINFI submission

A duplicate of the application must then be presented to the Ministry of Finance.

COBAC process

The Central African Banking Commission then reviews and decides on the application within six months.

For Non-Banks

Equity financing

Equity Financing is possible via angel investors, venture capital, private equity, and IPOs.

Strategic partnerships and joint ventures

Companies can form partnerships or joint ventures with other firms to access capital, technology, or distribution channels.

Debt financing
Debt financing is possible through the issuance of bonds, convertible debt, compound transferable securities, supplier credit, and trade credit (companies can negotiate deferred payment terms with customers, effectively obtaining financing from their accounts receivable).

Collective Investment Schemes (CIS)
These are structured as portfolios that can pool funds from multiple investors. The types of CIS available include:

- CIS in Transferable Securities (CIS-TS); and
- Alternative Investment Funds (AIFs).

Innovative financial instruments
The introduction of instruments like Islamic finance securities.

Emerging Regulatory Frameworks

Regulatory changes
These include:

- General Regulation of COSUMAF as of 23 May 2023; and
- Regulation No 1/22/CEMAC/UMAC/CM/COSUMAF dated 21 July 2022.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Regulation of Foreign Lenders Providing Loans in Cameroon

Freedom to lend
Foreign lenders can issue loans in Cameroon, according to Regulation No 02/18/CEMAC/UMAC/CM of 2018, governing CEMAC's foreign exchange.

Declaration
Loans from non-resident entities must be declared to the Ministry of Finance (MINFI) 30 days prior to disbursement.

Documentation
Declarations must include the loan contract, repayment schedule, and borrower's financial statements.

Post transaction
Within 30 days post-loan, borrowers must provide proof of effective loan utilisation.

Credit institutions
It is permitted to execute international transfers for loan repayment upon furnishing relevant documentation.

Repayment reporting
The MINFI and Central Bank must be informed within 30 days of repayments.

3.2 Restrictions on Foreign Lenders Receiving Security

The Uniform Act on Securities (AUS) under OHADA does not restrict the nationality of lenders or the provision of security to foreign entities.

The AUS categorises securities as personal and real, stating that real securities are valid per Uniform Act provisions and may be established by debtors or third parties.

Community law specifies some securities, like those related to water, air, and maritime law, as well as interests not covered by the Uniform Act or between financial institutions, that could be subject to specific legislation.

3.3 Restrictions and Controls on Foreign Currency Exchange

Restrictions and Controls on Foreign Currency Exchange

Enhanced administrative control

Transactions exceeding XAF1 million per month per entity are generally unrestricted, provided the origin of the funds to be transferred is justified, and the requested documents are supplied to certified commercial banks. These measures aim to combat money laundering and terrorism financing.

Opening foreign currency accounts

Opening a foreign currency current account outside the CEMAC member states now requires authorisation from the BEAC (Bank of Central African States). Similarly, opening such accounts within CEMAC member states also necessitates BEAC authorisation.

Repatriation of export earnings

The obligation to repatriate export earnings remains in place, with no exceptions provided.

Importation of goods

Importation of goods within the CEMAC region is generally unrestricted, except for gold and other goods subject to specific regulations. Member states, including Cameroon, have some discretion to impose additional restrictions on goods imports for humanitarian, health, security, or environmental reasons. All goods imports must be declared to customs.

Expanded role of BEAC

The foreign exchange regulation strengthens the role of the BEAC by involving it more in transaction reporting, authorisation, monitoring compliance with exchange regulations, and interpreting CEMAC regulations.

3.4 Restrictions on the Borrower's Use of Proceeds

Restrictions on the Use of Loan Proceeds and Debt Securities

- In principle, borrowers must use the proceeds from loans or debt securities in accordance with the terms and conditions specified in their contract.
- Borrowers are obliged to adhere to the principles of public policy and good morals as per Article 1134 of the Cameroonian Civil Code.
- Borrowers must provide documentation verifying the origin of the borrowed funds or issued securities to prevent money laundering and terrorist financing.
- Suspicious transactions may be reported to relevant authorities to ensure compliance with anti-money laundering and counter-terrorism financing regulations.
- When funds are borrowed from foreign sources, borrowers must additionally comply with foreign exchange regulations, particularly as outlined in Article 105.
- Failure to comply with foreign exchange regulations may result in the borrower losing access to the funds.
- Borrowers are required to meet both contractual obligations and regulatory requirements to use the borrowed funds effectively.

3.5 Agent and Trust Concepts

Agent

According to OHADA's Uniform Act on General Commercial Law, a commercial agent negotiates and possibly finalises contracts for third parties in sectors like sales and services. There are the following agent types:

- A placement agent facilitates issuance and distribution of securities.
- A security agent oversees compliance with secured financing terms.

- A facility agent mediates between syndicate lenders and borrowers.
- A financial agent offers financial services like payment processing and treasury management.

Trust

In finance, a trust is a legal construct where a trustor assigns a trustee to manage assets for a beneficiary.

Equivalents

- Fiduciary transfer: as defined in the AUS, it involves transferring money to a restricted account as collateral.
- Collective investment schemes: similar to trusts, they manage assets for third-party benefits.

3.6 Loan Transfer Mechanisms

In CEMAC, loan transfer mechanisms rely on contractual practices, as well as legal statutes. Key contractual elements are outlined below:

- Assignment of loans involves contractual agreements between the assignor (current lender) and assignee (new lender) and spells out rights and obligations being transferred.
- Transfer of securities like pledges are transferred as part of the agreement and terms of securities are laid out in the contract.
- Borrower's consent is obtained via formal acknowledgment and ensures transparency and compliance.

Under Cameroonian law, this transaction can take two forms:

- an assignment of a claim under the Cameroon Civil Code; or
- an assignment of a claim by way of security (which is a security in its own right) under the AUS.

In accordance with Article 1689 of the Cameroon Civil Code, in the transfer (assignment) of a claim, right or action against a third party, delivery takes place between the assignor and the assignee by delivery of the document of title. The essential element in an assignment of claims is the guarantee of the existence of the claim, without which the assignment will be devoid of any purpose (Article 1693 of the Civil Code).

Under OHADA law, the assignment of a claim by way of security must be notified to the debtor of the assigned claim in order to be enforceable against them. Failing this, the debtor must intervene in the deed (Article 84 of the AUS). With regard to registration, in accordance with Article 82 of the AUS, a contract for the assignment of a claim by way of security takes immediate effect between the parties, regardless of the date on which the assigned claim arises, falls due or is payable, and is enforceable against third parties from the time it is entered in the Trade and Personal Property Credit Register (TPPCR).

3.7 Debt Buy-Back

Debt buy-back by the borrower or sponsor is not specifically regulated in the CEMAC region by specific regulations or legal provisions.

However, this does not mean that debt buy-back is entirely prohibited. On the contrary, the possibility of repurchasing debt depends primarily on the terms and conditions specified in the loan or borrowing agreement between the borrower and the lender. These terms can vary from one contract to another and may either permit or restrict the repurchase of debt by the borrower or sponsor.

3.8 Public Acquisition Finance

In the context of CEMAC banking law, it is important to note that "certain funds" provisions are not explicitly regulated by specific legal provisions within the region. Rather, they are typically governed by contractual agreements between parties involved in acquisition finance transactions.

The ways in which certain aspects of "certain funds" may be addressed in CEMAC banking practice are outlined below.

Contractual Agreements

The rules regarding "certain funds" in public acquisition finance transactions within CEMAC countries are primarily established through contractual agreements between the relevant parties, including the borrower, lenders, and arrangers. These agreements specify the obligations of the parties to ensure that the necessary funds are available and committed for the acquisition.

Documentation

The choice between short-form or long-form documentation in CEMAC banking transactions may depend on the complexity and size of the transaction. Short-form documentation is commonly used for straightforward transactions, while long-form documentation provides more comprehensive details for complex deals.

Public Filing

In CEMAC, the documentation related to acquisition finance transactions is not typically publicly filed unless required by local regulations or stock exchange rules.

3.9 Recent Legal and Commercial Developments

We have not encountered any recent legal or commercial developments that necessitated revisions to our legal documentation.

3.10 Usury Laws

There are legal provisions that limit the amount of interest that can be charged in the CEMAC region, including Cameroon. Here are the key points to consider:

Usury Laws in CEMAC

Regulation No 04/19/CEMAC/UMAC/CM regarding the Effective Global Rate, the prevention of usury, and the publication of banking conditions in the CEMAC region indicates that any agreement concealing a loan in any form and by any person, at a rate which, at the time it is granted, exceeds the usury rate set by the Central Bank's Monetary Policy Committee, constitutes a usury loan.

Cameroon's Legal Framework

In Cameroon, Article 1907 of the Civil Code requires that loan agreements do not exceed the legally set interest rate.

Article 3 of Law No 2004/015 of 21 April 2004, which fixes the legal interest rate for the execution of judicial decisions and the conventional interest rate, states that the conventional interest rate cannot exceed the rate set by the monetary authority, plus one point.

The reference rate is the average annual Effective Global Rate (TEG) used by credit institutions. For the fourth quarter, the TEG average is communicated by the Minister of Finance.

Penalties for Non-Compliance

The CEMAC Regulation provides for penalties, including imprisonment ranging from one to six months and fines ranging from XAF100,000 to XAF100 million or one of these two sanctions (Article 32).

The Cameroonian Penal Code prescribes a fine ranging from XAF5,000 to XAF1,000,000 and a prison sentence of 15 days in case of recidivism, along with a doubled fine.

3.11 Disclosure Requirements

Cameroon's Banking Secrecy Law, enacted on 27 April 2022, outlines rules for financial contract disclosure. Key provisions include the following:

- Confidentiality: Financial institutions must maintain client confidentiality.
- Limited disclosure: Exceptions exist for judicial, tax, and anti-corruption authorities.
- Client protection: The law aims to safeguard clients' personal and financial information.

4. Tax

4.1 Withholding Tax

In Cameroon, payments to lenders are subject to specific tax regulations:

- VAT of 19.25%:
  (a) applicable to banking services based on the borrower's location;
  (b) exempt if the borrower is overseas; and
  (c) can apply to principal, interest, and other associated sums.
- Capital gains tax of 16.5%:
  (a) applies to interest income among financial institutions within the same corporate group.

4.2 Other Taxes, Duties, Charges or Tax Considerations

In lending to entities in our jurisdiction, two main charges are typically relevant:

- Registration duties: 1-5% fees may apply to formalise financing agreements.
- Stamp duty: This is levied on legal instruments like promissory notes or loan contracts.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

In Cameroon, foreign lenders and non-traditional banks face several tax and regulatory issues, which can be mitigated as follows:

- Double Taxation: This is mitigated through double taxation treaties.
- Withholding tax: This is reduced by structuring loans or leveraging tax treaties.
- Transfer pricing: This is addressed by setting arm's length loan terms.
- Regulatory compliance: Risks here can be mitigated through consultation with local legal experts and strong compliance procedures.
- Exchange rate risk: This is typically managed via financial instruments like forwards or swaps.
- Political risk: This can be mitigated by acquiring political risk insurance.

5. Guarantees and Security

5.1 Assets and Forms of Security

Under OHADA law, assets available as collateral to lenders fall into three categories:

- personal security, which includes surety, guarantee, and counter-guarantee;

- movable property security, which covers rights of retention, property as collateral, pledges, and liens; and
- mortgages, which pertain to immovable property.

The AUS outlines formalities for these collaterals, modernising credit guarantees and procedures. Failure to meet these formalities renders the security unenforceable. In bankruptcy, new security against old debt is unenforceable if taken 18 months before insolvency.

5.2 Floating Charges and/or Similar Security Interests

OHADA law allows for a universal security interest over a company's current and future assets, akin to the "floating charge" in other jurisdictions. Under the AUS, assets can be assigned to secure obligations, covering both present and future assets.

However, implementation specifics may vary and certain conditions must be met. For instance, the AUS allows parties to agree that, upon non-payment, the secured creditor gains ownership of money or officially quoted assets pledged.

5.3 Downstream, Upstream and Cross-Stream Guarantees

In Cameroon, entities can offer downstream, upstream, and cross-stream guarantees, involving both parent companies and their subsidiaries provided that the formalities of validation of regulated agreements are followed according to Articles 350, 438, 502 and 853-14 of the OHADA Uniform Act on Commercial Companies and Economic Interest Groups. Under OHADA law, various security interests can be employed in such contexts:

- Mortgage: A mortgage on real estate or significant assets can secure debts between a parent and its subsidiaries.
- Pledge: A pledge allows a creditor to seize the subsidiary's personal property upon default, securing financial obligations.
- Pledge of bank accounts: This grants creditors rights over a subsidiary's bank accounts, used for financial security between the parent and subsidiary.
- Pledge of receivables: A creditor gains rights to the subsidiary's third-party receivables, serving as security.
- Assignment of receivables: This transfers the right to claim from the subsidiary to the parent or creditor, serving as debt collateral.
- Suretyship: A third party, often the parent, guarantees the subsidiary's debts (useful for inter-company guarantees).

5.4 Restrictions on the Target

Under Article 639 of the OHADA Uniform Act on Commercial Company and Economic Interest Group Law, the target company is explicitly prohibited from "granting security for the subscription or purchase of its own shares by a third party". This means that, in the context of an acquisition, the target company may not grant guarantees or securities to facilitate the acquisition of its own shares.

This article makes no exception for the possibility of granting security for the acquisition of its own shares. The extraordinary general meeting may authorise the purchase of its own shares only as part of a capital reduction not motivated by losses, but this does not extend to the granting of securities for the same purpose.

5.5 Other Restrictions

We have not identified any other specific restrictions, significant costs, or consents required

beyond those mentioned elsewhere in **5. Guarantees and Security**. It is essential to consider that the applicability of additional restrictions or requirements may vary depending on the specific circumstances and the relevant legal jurisdictions involved.

5.6 Release of Typical Forms of Security

Under OHADA law, security is typically released when the underlying obligation is met.

Obligation Fulfilment

The main way to release security is by meeting the obligation it was designed to cover. Once met, the creditor's claim on the security ceases.

Pledge Rules

If the pledged property has an official valuation, parties can agree that, upon non-payment, the creditor takes ownership. This does not happen if the debtor meets their obligation.

Enforcement

In case of non-payment, creditors may enforce the security, such as through public auction. This is unnecessary once the obligation is met.

5.7 Rules Governing the Priority of Competing Security Interests

Under OHADA's AUS Articles 225 and 226, the priority of competing security interests in Cameroon is as follows:

Priority in Immovable Property

- creditors for judicial costs;
- creditors with super-priority for wages;
- registered mortgage and security creditors, by registration order;
- creditors with publicly noted general privileges;
- other general privilege creditors, as per AUS Article 180;
- unsecured, enforceable-title creditors intervening via attachment; and
- if funds are insufficient, categories 1, 2, 5, and 6 share proportionally.

Priority in Moveable Property

- creditors for judicial costs;
- creditors for preservation expenses;
- wage-based super-priority creditors;
- publicly noted or pledged creditors, by enforceability date;
- special privilege creditors per specific asset;
- other general privilege creditors, per AUS Article 180;
- unsecured, enforceable-title creditors via attachment;
- enforceable-title creditors via attachment; and
- if funds are limited, categories 1, 2, 3, 6, and 7 share proportionally.

Contractual Priority Variations

Priority can be contractually altered within lender groups, provided it aligns with mutual agreements.

Contractual Subordination

Provisions survive a Cameroon-incorporated borrower's insolvency if well-drafted, legally enforceable, and OHADA-compliant.

5.8 Priming Liens

Under Cameroon law, material security interests that can prime a lender's security interest by operation of law typically involve statutory liens or claims that take precedence over other creditors' interests. Some examples include:

- tax liens: government entities can place tax liens on a company's assets for unpaid taxes; these liens typically have priority over other creditors, including secured lenders;
- creditors (public entities) with a treasury lien;

- wage-based super-priority creditors; and
- environmental liabilities: in cases where a company is responsible for environmental remediation costs, statutory environmental liens can arise, giving government agencies priority claims over other creditors.

There are several ways to structure around priming liens and protect a lender's security interest:

- Obtaining subordination agreements: The lender can negotiate with the holders of priming liens to obtain subordination agreements. These agreements would stipulate that the priming lienholders agree to subordinate their claims to the lender's security interest.
- Use of structured financing: Companies may use structured financing arrangements that involve special-purpose entities (SPEs) or bankruptcy-remote vehicles. These structures can isolate the lender's collateral from potential priming claims.
- Escrow accounts: Companies may set up escrow accounts to hold funds that will satisfy potential priming claims. This ensures that there are adequate funds available to address any priority claims.
- Insurance: Companies can purchase insurance policies to cover potential losses resulting from priming claims. This provides an additional layer of protection for the lender's collateral.
- Due Diligence: Prior to lending, thorough due diligence can help identify existing or potential priming liens. Addressing these issues upfront through negotiation or other means can reduce the risk to the lender.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Under OHADA law, loan default typically triggers collateral enforcement for secured lenders. The initial enforcement step involves notifying the debtor of the intended action. Failure to comply leads to legal action for debt repayment. If unsatisfied, the creditor may initiate insolvency proceedings.

The OHADA Uniform Act on Simplified Recovery and Enforcement Procedures (AUVE) outlines two methods to compel payment: injunction to pay and injunction to deliver or return property.

AUVE also regulates enforcement measures, including:

- provisional seizure: this encompasses tangible assets, debts, shareholder rights, and movable properties; and
- enforceable seizure: this includes methods like seizure and sale, garnishee, wage attachment, and attachment of immovable property.

6.2 Foreign Law and Jurisdiction

According to the general principles of private international law applicable in Cameroon, a clause that chooses a foreign law as the law governing the contract, or which submits to a foreign jurisdiction, will generally be accepted by Cameroonian courts, subject to certain conditions, outlined below.

Choice of Foreign Law

The choice of a foreign law as the law applicable to the contract is generally upheld, provided that it does not violate Cameroonian international public policy or mandatory local laws.

Submission to a Foreign Jurisdiction

The choice of a foreign jurisdiction to settle disputes arising from the contract is also likely to be recognised, unless the Cameroonian courts consider themselves exclusively competent due to the nature of the dispute or for reasons of public policy.

Waiver of Immunity

A waiver of immunity clause would require careful consideration. Jurisdictional immunity, particularly for states or state entities, is a complex issue that cannot easily be waived by a simple contractual clause.

Formal Requirements

The contract must be properly formalised, and jurisdictional clauses must be clearly set out to avoid any ambiguity.

6.3 Foreign Court Judgments

Under the legal framework provided by Law No 2007/001 of 19 April 2007, which governs the recognition and enforcement of foreign judicial decisions and foreign arbitral awards in Cameroon, the enforceability of a judgment given by a foreign court or an arbitral award in Cameroon is subject to specific procedures and conditions, as outlined below.

Competent Authority

The President of the Court of First Instance or a judge delegated by the President serves as the judge for disputes related to the enforcement of foreign judicial decisions and acts and foreign arbitral awards in Cameroon (Article 5 of the law).

Application for Recognition and Enforcement

To seek recognition and enforcement in Cameroon, the party must submit an application to the competent Cameroonian authority. This application should include the following documents:

- a copy of the foreign decision meeting the necessary conditions for authenticity;
- the original document that was used for service of the decision or any other act equivalent to service;
- a certificate from the clerk confirming the absence of opposition or appeal against the decision; and
- if applicable, a copy of the summons or notice to the party who defaulted in the proceeding, certified by the clerk of the court that rendered the decision, and any evidence demonstrating that this summons or notice reached the party in a timely manner (Article 6).

Verification by the Judge

The Cameroonian judge responsible for the enforcement of foreign decisions and arbitral awards will verify certain criteria:

- whether the decision originates from a competent foreign court;
- whether the parties were duly summoned, represented, and declared in default;
- whether the decision is enforceable in its country of origin; and
- whether the decision does not contradict Cameroonian public policy or a final Cameroonian judicial decision (Article 7).

Decision on Enforcement

The Cameroonian judge will issue a decision based on the verification results (Article 8). If the conditions are met, the judge may grant “exequatur” (recognition and enforcement). This recognition may be partial, applying only to specific aspects of the foreign decision.

Appeal
The decision of the judge responsible for enforcement can only be appealed before the Supreme Court (Article 8).

6.4 A Foreign Lender's Ability to Enforce Its Rights
There are no other matters that might impact a foreign lender's ability to enforce its rights under a loan or security agreement.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes
The commencement of insolvency processes under OHADA law significantly impacts a lender's ability to enforce its loan, security, or guarantee. The key implications are outlined below.

Suspension of Individual Actions
When insolvency proceedings begin, all individual creditor actions against the debtor are suspended or prohibited. Creditors cannot pursue outstanding debts individually during insolvency.

Creation of Collective Mass
Insolvency proceedings automatically create a collective mass of creditors represented by the appointed trustee (syndic). The trustee acts on behalf of this group and can take legal actions on its behalf, linking individual creditors to the process.

Impact of Redress Proceedings
If insolvency aims at redress or rehabilitation (*redressement judiciaire*), a *concordat de redressement* must be negotiated between the debtor and creditors, seeking solutions to the debtor's financial issues. Court approval marks the end of redress proceedings, and the debtor regains control while following the concordat's terms.

Outcome of Liquidation
In cases of liquidation (*liquidation des biens*), the business dissolves, and creditors are organised into a union. Creditors await the liquidation's outcome, with claims settled based on a legal hierarchy. Some creditors may not recover fully, resulting in losses.

Creditor Claims
Regardless of redress or liquidation, creditors must submit claims to insolvency proceedings, specifying the nature, amount, and guarantees. The court reviews and acknowledges these claims before determining their rank among creditors.

7.2 Waterfall of Payments
In the event of a company's insolvency under OHADA law, the order in which creditors are paid is determined by their legal ranking (Articles 225 and 226 of the AUS).

7.3 Length of Insolvency Process and Recoveries
In Cameroon, insolvency proceedings' duration varies based on several factors like initiator, outstanding debts, and procedure type (preventative settlement or liquidation). Creditor objections and the firm's financial health can also affect the timeline.

The quickest cases, initiated by companies keen on uncontested liquidation, may wrap up in approximately six months.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency
In OHADA jurisdictions, company rescue procedures outside formal insolvency are governed

by two mechanisms: conciliation and preventive settlement (*règlement préventif*).

Conciliation

The conciliation process is preventive, consensual, and confidential. The goal of negotiations between debtors and creditors is to reach a consensus and formalise it in a conciliation agreement. The key traits of this approach include a focus on prevention, achieving mutual agreement, maintaining confidentiality, and the involvement of a neutral conciliator. The overarching objective is to restructure either the finances or operations of the company to avoid insolvency.

Preventive Settlement (Règlement Préventif)

The preventive settlement mechanism aims to prevent insolvency and resolve debts through a concordat (debtor-creditor or court-approved concordats). The primary purpose is to avert insolvency and settle debts using a concordat as the resolution framework.

7.5 Risk Areas for Lenders

In Cameroon, there are several risk areas for lenders if the borrower, security provider, or guarantor were to become insolvent:

Enforcement of Loan

The commencement of insolvency proceedings generally triggers a stay of enforcement actions against the debtor. This means that lenders may be prevented from enforcing their loans during the insolvency proceedings.

Enforcement of Security

Similarly, the enforcement of security interests may also be stayed during the insolvency proceedings. However, secured creditors generally have priority over unsecured creditors in the distribution of the debtor's assets.

Value of Collateral

As a lender, one main risk is that the value of the collateral decreases below the cost of the security that was lent out.

Invalidation of Cover

The interests of the lender are completely separate from those of the borrower, so the lender's right to claim is unaffected if the borrower does anything to invalidate the cover.

Automatic Liability

The guarantor to a facility automatically becomes liable to the creditor upon default by the borrower.

8. Project Finance

8.1 Recent Project Finance Activity

Project finance in Cameroon aims to fill infrastructure gaps and stimulate economic growth. Key insights include:

Major Projects

Cameroon's government has laid out noteworthy second-generation projects for 2020-2030. The IMF highlights financial challenges and advises prudent planning.

Infrastructure

Focus areas are transportation, hydropower, sanitation, and ports. Notable is the Nachtigal Hydropower Project, a public-private initiative to address power issues.

Financing

Central sectors are transportation, energy, and sanitation. Funding combines government resources, loans, and collaborations with international financial entities like the African Development Bank.

8.2 Public-Private Partnership Transactions

Cameroon is committed to fostering public-private partnerships (PPPs) to address infrastructure deficits and drive economic development.

Significantly, the legal framework for PPPs was strengthened with the enactment of Law No 2023/008 of 25 July 2023, establishing the general regime for public-private partnership contracts in Cameroon. This recent legislation underscores Cameroon's commitment to structuring and promoting PPPs for crucial infrastructure projects and to boost economic growth.

In addition to these laws and regulations, there are guidelines for PPP procurement in Cameroon, covering the Expression of Interest document, bidding advice, bid evaluation, and bidder prequalification, among other aspects.

The country established its PPP policy framework between 2005 and 2009, with 21 projects disclosed in 2013 in areas like transport, urban development, energy, and agri-food.

Potential PPP transaction challenges may include strict regulations, bureaucracy, regulatory ambiguity, and financing difficulties. Understanding Cameroon's PPP legal and regulatory landscape is vital for effective engagement.

8.3 Governing Law

The applicable laws and dispute resolution procedures for project documents in Cameroon can be complex and depend on contract terms and the nature of the relevant project. Here is a condensed overview.

Dispute Resolution

Litigation or ADR

Cameroon offers litigation or alternative methods like arbitration or mediation for disputes.

Arbitration for projects

Arbitration, chosen in project contracts, may streamline future disputes under different contracts.

Governing Law

Contracts specify the governing law and dispute resolution procedure. Parties often have autonomy unless local laws restrict choices.

International arbitration is common in international contracts, impacting enforceability and dispute resolution.

Local Laws and Regulations

Cameroon's legal framework is influenced by both the French civil law and the English common law traditions due to its bilingual and bijural nature. This duality could impact the governing laws and dispute resolution mechanisms for project documents.

Cameroon has a Public Contracts Code that sets out the rules applicable to the award, execution, and control of procurement, which might influence project contracts within the country.

8.4 Foreign Ownership

Foreign Ownership of Real Property

Based on Ordinance No 74-1 of 6 July 1974 regarding the real estate regime in Cameroon

Foreign individuals or legal entities wishing to invest in Cameroon can conclude leases or acquire real estate properties, except in border areas, as stipulated by Article 10 of the aforementioned ordinance. The acts for such transac-

tions must be endorsed by the relevant ministerial authorities to be valid.

Water Rights

In Cameroon, water rights are generally exercised over lands of the public maritime and fluvial domains, among others. According to Ordinance 74/2, establishing the domain regime, lands of the public domain are inalienable, meaning they cannot be transferred to others either for a fee or for free. They cannot be part of any transaction leading to their transfer to individuals or state organs.

Remedial Rights on Liens by Foreign Lenders

The ordinance does not explicitly address the rights of foreign lenders holding or exercising remedial rights on liens on any such property. However, Articles 7 and 8 set out the conditions for obtaining land titles and the establishment of real estate rights on properties, which could extend to remedial rights on liens by lenders.

Restrictions and Legal Requirements

Certain legal formalities are required for the validity of acts relating to real estate transactions, as laid out. Furthermore, in case of resale, the state has a pre-emptive right to repurchase the property.

8.5 Structuring Deals

Structuring a deal and determining the legal form of a project company in Cameroon entails a thorough understanding and consideration of various legal, regulatory, and financial facets. Here is an overview of the main issues and relevant laws.

Legal Form of Project Company

Project companies in Cameroon often take the form of a corporation or a limited liability company.

The key laws are the OHADA Uniform Act on General Commercial Law, OHADA Uniform Act on Commercial Companies and Economic Interest Groups.

Foreign Investment

There are no general restrictions on foreign investment, but certain sectors may have specific regulations.

The key laws are the Investment Charter of Cameroon, and specific regulatory laws.

Central Bank Regulations

Monetary policy and financial regulation are overseen by the Bank of Central African States (BEAC).

Key regulations pertain to foreign exchange control, monetary transfer, and lending regulations.

Relevant Treaties

Cameroon is a party to various international treaties and agreements that could impact project structuring and operations.

Examples include treaties within the CEMAC (Economic and Monetary Community of Central Africa) region, and bilateral investment treaties.

Regulatory Approvals and Compliance

The relevant approvals are required from governmental and regulatory bodies like the Ministry of Finance, the National Anti-Corruption Commission, and sector-specific authorities.

Local laws, including labour laws, environmental regulations, and tax laws, must be complied with.

Financing
Financing of the project must be structured in compliance with local and international financial regulations and standards.

Taxation
Adequate planning and compliance with taxation laws are crucial for the financial viability of the project.

The key laws are the General Tax Code of Cameroon, the various Finance Acts and their implementing circulars.

Contractual Agreements
Clear and enforceable contracts for construction, supply, operation, and other critical project components must be drawn up in accordance with local laws and international standards.

Dispute Resolution
Clear dispute resolution mechanisms must be established within contracts. It is also important to understand the legal framework for dispute resolution in Cameroon.

Insurance
Appropriate insurance cover should be in place to mitigate project risks.

Environmental and Social Compliance
National and international environmental and social standards and regulations must be complied with.

Intellectual Property Protection
Any intellectual property associated with the project must be complied with in accordance with Cameroonian laws and international treaties.

8.6 Common Financing Sources and Typical Structures
Project finance in Cameroon encompasses a variety of funding sources and structures. The financing framework often mirrors international standards, while also reflecting the country's economic landscape and regulatory environment. Below is an overview of typical financing sources and structures employed in project financings within Cameroon.

Bank Financing
Traditional bank loans remain a prevalent source of project financing. Local and international banks provide loans with varying terms and conditions based on the project's viability and the borrower's creditworthiness.

Syndicated loans, involving multiple banks, are also common for larger projects.

Export Credit Agency (ECA) Financings
ECAs provide financial support to promote exportation and often support projects that will utilise exports from their respective countries.

ECA financing can provide favourable terms including lower interest rates and extended repayment periods, enhancing the project's financial feasibility.

Project Bonds
While not as common as bank financing, project bonds can be issued to raise capital from public or private investors. This method is more likely to be used for larger, well-established entities or projects with predictable cash flows.

Alternative Financing Sources
Streaming or royalty financing
This is more common in the mining sector where a company receives upfront financing in

exchange for a percentage of future production or revenues.

Private equity funding

Private equity firms may provide capital in return for equity stakes in the project. This is a common financing mechanism for startups and growing companies.

Commodity trader financing

This involves financing from commodity trading companies, often structured around the purchase and sale of the project's output.

Development Financial Institutions (DFIs)

DFIs like the African Development Bank provide financing with preferential terms to promote economic development. They often participate in project financings, especially in infrastructure and energy sectors.

Multilateral and Bilateral Funding

Funding from multilateral institutions and bilateral agreements between countries can also be a significant source of project financing, especially for large-scale infrastructure projects.

Government Grants and Subsidies

Governmental grants and subsidies may be available for projects aligning with national development goals or those in priority sectors.

PPPs

PPPs are increasingly being used to finance infrastructure projects. These partnerships leverage both public and private sector resources to finance, develop, and operate projects.

Microfinance Institutions

For smaller projects or entrepreneurs, microfinance institutions offer an accessible source of financing, though usually at higher interest rates.

Supplier Credit

Supplier credit can also be a source of project financing, where suppliers provide goods or services on deferred payment terms.

Leasing

Leasing arrangements for equipment or other assets are also common, especially in projects where upfront capital is limited.

8.7 Natural Resources

In Cameroon, managing natural resources involves various considerations linked to the nation's legal framework. Key aspects include export limitations and local beneficiation.

Export Control

Cameroon restricts the export of raw materials, especially petroleum products, aiming to promote local processing and value addition. This approach maximises economic benefits from natural resources and boosts the nation's industrial sector.

Local Value Addition

Cameroon encourages local processing of natural resources to generate more economic value. This process drives industrial development, job creation, and economic diversification. The regulatory framework, including the Mining Code, emphasises local transformation before resource utilisation or export.

Legal Framework

Cameroon's natural resources sector operates under several laws and ordinances, notably the Mining Code and Petroleum Code. These legal instruments outline rights, obligations, and regulatory compliance for stakeholders. They govern exploration, exploitation, and resource management within Cameroon's jurisdiction.

8.8 Environmental, Health and Safety Laws

In Cameroon, various laws and regulatory bodies oversee environmental, health, safety, and community consultation concerns for projects. Below is an overview of some of the key aspects.

Environmental Laws

Topics covered under environmental laws include environmental management, water and land law, conservation of biodiversity, resource protection, mining and energy law, climate change law, environmental justice, and human rights. The legal frameworks pertaining to international trade and sustainable development are also under the purview of environmental laws.

A significant legislation is Law No 96/12 of 5 August 1996 relating to Environmental Management in Cameroon, which encompasses aspects such as Environmental Impact Assessment (EIA).

Occupational Safety and Health (OSH) Laws

The primary legislation for health and safety at workplaces is Order No 039/MTPS/IMT of 26 November 1984, which sets the general rules of hygiene and safety at the workplace as well as Law No 96/03 of 4 January 1996 establishing a framework law in the field of health.

The national regulatory framework for Occupational Safety and Health (OSH) is outlined on the International Labour Organization's (ILO) platform, providing a picture of the main elements of OSH legislation in Cameroon.

Health Regulations

The Directorate of Pharmacy, Medicines and Laboratories (DPML) regulates pharmaceuticals under Law No 90-035 of 10 August 1990, which establishes general rules for the practice and organisation of the pharmacy profession. Additionally, Framework Law No 2018/020 of 11 December 2018 regulates food and supplements. Each body oversees compliance in their domains, adhering to national health standards in synergy with the National Authority for Standards and Quality (ANOR).

Community Consultation

While the specific laws or bodies governing community consultation were not found in the provided sources, the Environmental Impact Assessment (EIA) process usually involves community consultation to assess and mitigate the social impacts of projects.

Regulatory Bodies

Various ministerial decrees and orders form the scope of health and safety legislation for companies and industries, implicating different governmental departments in the oversight of these areas.

CANADA

Law and Practice

Contributed by:
Mark Rasile, Denise Bright, Yannick Beaudoin and Simon Grant
Bennett Jones LLP

Contents

Bennett Jones LLP has a banking and finance group which routinely acts for leading domestic and foreign banks and financial institutions, as well as a deep, blue-chip roster of corporate and private equity sponsor clients. It is at the forefront of the market acting for alternative lenders, including managers of substantial institutional capital pools, direct private equity lenders and hedge fund debt investors in high-value, market leading mandates. It routinely advises on the structuring and documentation of domestic and cross-border syndicated and bilateral loan facilities, including leveraged acquisitions, takeover and tender bid financings, project financings, 1st/2nd lien structures, unitranche financings, complex intercreditor arrangements and restructurings (including some of the largest DIP loan facilities in the Canadian market). Its lawyers also offer clients a broad spectrum of legal and advisory services geared toward the changing needs and demands of the financial services industry. The firm has extremely close relationships with a number of senior regulators.

Authors

Mark Rasile helps clients of Bennett Jones LLP navigate the areas of lending and finance, both in private and public debt capital markets and through alternative credit sources and traditional commercial banks. Mark has broad experience advising on various types of financing transactions, routinely acting for a wide range of domestic and foreign credit providers, including banks and alternative lenders, borrowers and sponsors. He advises on both domestic and cross-border syndicated loan financings, acquisition and takeover bid financings, 1st/2nd lien structures, unitranche financing, complex intercreditor arrangements, workouts, restructurings, public and private bond offerings, and other debt capital markets transactions.

Denise Bright is well-known for being creative, practical and business-oriented. She acts as senior lead counsel and lead Canadian counsel for Bennett Jones LLP on domestic and cross-border complex financial transactions for a wide variety of clients operating in a diverse array of industries. Denise has a breath of unique deal experience. Her recent financing firsts include lead finance counsel to the co-owner and borrower in respect to the first Alberta Indigenous Opportunity Corporation (AIOC) loan guarantee and borrower and sponsor lead finance counsel to the largest urban solar project in western Canada and the first operational solar financing by Canada Infrastructure Bank in Alberta.

Yannick Beaudoin has 25 years of experience in infrastructure and project development, project finance, banking and financial services, real estate and asset-based finance. Within Bennett Jones LLP, he acts for clients in Québec, across Canada and internationally in a wide range of high-profile, complex and leading projects. He advises project proponents in the transportation, social infrastructure, alternative energy, power and healthcare sectors, as well as bond underwriters, institutional investors and banks in financing these assets. Yannick's experience serving infrastructure clients spans a wide range of fields, including transactions in healthcare, power, transit, tolls, education, energy, hydrogen, wastewater, pipelines and urban redevelopment.

Simon Grant is co-head of the banking and secured transactions practice group of Bennett Jones LLP. He practises corporate and commercial law, with an emphasis on financing transactions and financial regulation. He routinely acts for borrowers, credit providers and sponsors on loan facilities, complex M&A transactions and financings in the mining sector, including streaming and offtake transactions. Simon is also co-head of the cross-disciplinary fintech practice group of the firm. He advises clients on financial regulation, including fintech companies and foreign financial institutions doing business in Canada.

Bennett Jones LLP

Suite 3400
1 First Canadian Place
Toronto
Ontario
M5X 1A4
Canada

Tel: +1 416 863 1200
Fax: +1 416 863 1716
Email: marketing@bennettjones.com
Web: www.bennettjones.com

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

The elevated rate environment has had a similar impact on the bank finance markets in Canada as it has in the US and European markets. While the large Canadian banks have generally continued to remain open to new lending, the cost of new money to domestic borrowers and issuers has had a dampening effect on new money financings and refinancings. This coincides with the softer Canadian M&A market observed through much of 2022 and early 2023.

While regulatory concerns have had less of a direct impact on Canadian banks than those of its neighbour and largest trading partner, the current economic cycle has caused the largest domestic lenders to more carefully analyse credits, moderately tighten lending standards and increase pricing margins. As a result, many borrowers have looked more to amend and extend terms where possible rather than pursuing refinancing options in order to avoid having their debt re-priced and covenants re-examined in the current environment.

1.2 Impact of the Ukraine War

Aside from consequential sanctions which are now often more precisely reflected in AML and related terms in documentation, there has been no observed impact on the Canadian loan market or deal terms or trends.

1.3 The High-Yield Market

The Canadian dollar high-yield market has continued to grow in scale over the last decade, offering a viable financing option to Canadian issuers that had not previously been well developed. The country's domestic high-yield market is often accessed by junior issuers in the mining and oil and gas sectors.

The Canadian dollar high-yield market remains small relative to the Canadian loan market when compared to the US dollar high-yield market and its size and scope vis-à-vis the US loan market. Given Canada's proximity to the major US money centres and related US investor pool, many Canadian issuers looking to do a high-yield offering continue to look to the US market to do so. Those transactions commonly are done under NY law. As a result of the familiarity Canadian issuers and underwriters have the US market, terms and trends, and also due to its proximity and easy access to the key US financing hubs, many of the trends and developments coming out of the US high-yield market (and also to some degree to the US loan market, depending on the dollar values of a particular transaction) migrate to the terms seen in the much smaller-scale Canadian dollar high-yield market.

1.4 Alternative Credit Providers

There has been a steady growth of alternative lenders and private credit originating and transacting on new financings in the middle market and lower-middle market. While that has been a somewhat recent development, there has for some time also been a number of domestic non-bank credit providers that focus on certain industries, asset classes or distressed opportunities. There are also a small number of larger alternative lenders, often backed by institutional money (pension funds, larger family offices, etc), that very selectively have arranged unilaterally, or together with a small "club" of similar alternative lenders, larger value financings.

The growth of the alternative lender/direct lender market in the Canadian loan market, and their relevance in this market, is not yet at the same

level as in the US. While it is not uncommon to see US PE direct lenders financing M&A that has a material Canadian component, or that may be specifically in respect of a Canadian target, that is typically in the context of a US buyer calling on its preferred financing sources to support the "Canadian M&A" opportunity. The writers have not yet observed, to the same degree as seen in the US markets, Canadian banks being displaced by alternative lenders in the Canadian leveraged finance markets.

Of some interest is the fact that the largest Canadian pension funds have increasingly made direct lending a meaningful part of their business and investment portfolio. However, that has not yet translated into those institutions building a significant presence or position in the country's domestic lending markets.

1.5 Banking and Finance Techniques

Sponsors have continued to finance investments utilising payment-in-kind (PIK) debt and preferred equity instruments, both of which have become more common in the Canadian and cross-border lending markets. The increased use of these instruments appears to be driven both by investor appetite and as a result of borrowers' interest in flexible capital solutions that allow for greater preservation of cash flows (whether to service other debt, to pursue growth or otherwise). In addition, sponsors utilise PIK financings, which may or not be secured, to increase their position in the capital structure in particular in highly leveraged or distressed situations. However, it is not clear that these instruments are used in Canada to the same degree as in the US or other markets, and experience suggests they are comparatively less common in the domestic lending market. However, in a higher interest rate environment, use of PIK loans and preferred equity instruments may see increased use as equity-like bridge capital where preservation of cash flow is important. Canadian pension funds and other private lenders have provided more PIK loans and preferred equity instruments in their investments, particularly outside of Canada and in the cross-border lending market, where experience reflects trends in the US and other markets. The writers have also seen a number of government programmes providing financing or grants in particular in the areas of exports and renewables. Alternate lenders have also been seen to take warrants as a way to increase their returns to offset a lower interest rate.

1.6 ESG/Sustainability-Linked Lending

This has become a fairly entrenched part of the Canadian financing landscape and, in particular, with listed entities. While there have been no recent new developments on this front, SLLs are very much in favour among both the largest banks and mature Canadian borrowers across all business and industry sectors. It is common to find sustainability-linked pricing now included in large corporate credits. The authors have not seen a significant uptake of SLLs in medium to smaller credits beyond what is required under securities legislation.

2. Authorisation

2.1 Providing Financing to a Company

In order to carry on business in Canada, banks (whether Canadian or foreign) are required to be licensed under the Bank Act (Canada) by the Office of the Superintendent of Financial Institutions (OSFI), Canada's banking regulator. Foreign banks may lend to Canadian companies without being licensed by OSFI if the foreign bank's activities are undertaken outside Canada.

Non-bank lenders are not subject to licensing by OSFI, and require only the minimal registration and licensing required of any business carrying on business in Canada.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Canadian subsidiaries of foreign banks that are licensed by OSFI to carry on business in Canada are subject to the same capital adequacy rules with respect to loans on their balance sheet as Canadian banks. Authorised foreign bank branches in Canada are not subject to OSFI's capital adequacy rules (as they are presumed to be subject to equivalent regulation in their home jurisdiction).

Foreign non-bank lenders are not restricted from providing loans to Canadian companies.

All loans in Canada will be subject to Canadian usury laws which limit the amount of interest and certain fees that can be charged.

Loans to natural persons in Canada are subject to provincial consumer protection legislation in the province where the consumer resides. Such regulation can be onerous to lenders and in some provinces, consumer lenders are required to be licensed.

3.2 Restrictions on Foreign Lenders Receiving Security

Receiving and enforcing security in Canada (by way of sale or receiver) is not considered carrying on business in Canada, provided that the lender was acting from outside Canada in taking the security.

3.3 Restrictions and Controls on Foreign Currency Exchange

Canada does not impose currency or exchange controls.

An entity that engages in the business of exchanging foreign currency (including cryptocurrency), either in Canada or from outside Canada directed to Canadian residents, is required to register as a money services business with the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), Canada's anti-money laundering regulator, and is subject to anti-money laundering rules and oversight by FINTRAC.

3.4 Restrictions on the Borrower's Use of Proceeds

Canadian loan documents typically restrict the use of proceeds to specific purposes which can include for general corporate purposes. The borrower will typically be prohibited from using proceeds in contravention of anti-money laundering and sanctions law in Canada and other applicable countries.

3.5 Agent and Trust Concepts

The appointment of an administrative agent and collateral agent by a lender syndicate is an enforceable contractual arrangement under Canadian law. Trusts are recognised concepts in Canadian law and a bank or trust company commonly acts as trustee in financings where debt securities are issued by a borrower. There are no common alternatives to the agency or trust structures.

3.6 Loan Transfer Mechanisms

The transfer of economic interests in a loan are governed by the loan agreement and may be transferred by way of assignment or by sale of a participation in the loan. In a permitted assign-

ment, all or a portion of the loan is sold to a purchaser which becomes party to the loan agreement and can vote on all matters requiring lender approval. In the sale of a participation, a portion of a lender's economic interest in the loan is sold and the purchaser has the right to receive principal and interest payments but is not party to the loan, and their voting rights are limited to matters affecting their fundamental rights under the loan. If the entirety of a loan is sold, the loan's security will be assigned to the purchaser. However, if a participation is sold, or an individual lender's loan in a syndicated loan is assigned, the original lender or collateral agent will retain the security.

3.7 Debt Buy-Back

Debt buy-backs by a borrower or its sponsor are permitted, subject to the provisions in the loan agreement. Typically, a borrower makes a rateable offer to all its debt holders and purchases its debt by Dutch auction. The purchased debt is then extinguished. A sponsor typically has the right to purchase debt (up to a limit) from an individual lender on the open market. A sponsor may hold the purchased debt subject to limitations on voting.

3.8 Public Acquisition Finance

Certain funds or "SunGard" conditions are very usual but not mandatory in Canadian acquisition finance and are commonly negotiated and accepted by acquirers and their financing sources, and are often a required feature demanded by Canadian targets in any acquirer financing package, particularly in an auction or competitive bidding scenario.

Under the Canadian takeover bid rules, acquirers bidding on a Canadian publicly listed target company must make adequate financing arrangements before making a bid. This does not require that the financing be entirely unconditional, but rather that the bidder reasonably believe that the possibility is remote that it will not be able to pay for the securities subject to the takeover bid.

Typically, for an acquisition with certain funds, a commitment letter containing a term sheet is signed by the purchaser and the lender underwriting the financing at the same time the purchaser enters into the acquisition agreement with the target. Subsequently, the purchaser and lenders enter into the definitive documentation for the financing at the same time the acquisition closes.

3.9 Recent Legal and Commercial Developments

For variable rate loans, Canadian regulators have mandated the transition from the Canadian Dollar Offered Rate (CDOR), a benchmark based on the rate banks lend via bankers' acceptances, to the Canadian Overnight Repo Rate Average (CORRA), a benchmark based on repo transactions of government of Canada debt. New loan contracts must reference CORRA and not CDOR after 1 November 2023, and CDOR will cease being published after 28 June 2024. Bankers' acceptances are also being phased out as part of the CORRA transition.

3.10 Usury Laws

The Criminal Code (Canada) limits interest (including most fees and expenses charged by a lender) to an annual effective rate of 60%. The government of Canada recently introduced proposals to lower the maximum legal interest rate to an annual percentage rate of 35%.

3.11 Disclosure Requirements

The Interest Act (Canada) requires that all interest rates be expressed as an annual rate. If an agreement contains an interest rate that is

expressed for a period of less than one year, the interest rate may be capped at a 5% annual rate. Listed companies are required to file all material contracts outside the normal course of business or credit agreements with terms that have a direct correlation with anticipated cash distributions which may include provisions restricting dividends or debt covenants and certain events of default.

4. Tax

4.1 Withholding Tax

Payments of principal are not subject to Canadian withholding tax. Subject to certain exceptions, non-participating interest and customary fees paid to arm's length lenders are generally not subject to Canadian withholding tax. In the case of payments of interest to US residents who are entitled to the benefits of the Canada-US tax treaty, such interest paid to a person who does not deal at arm's length with the Canadian payor is also exempt from Canadian withholding tax.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Generally, the making of loans (and granting of security or guarantees in connection therewith) is not subject to any registration or transfer tax, stamp duty or similar levy in Canada. Personal property security filings have nominal fees and filing fees for mortgages or real property are based on the amount of the loan or the value of the property.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Canadian tax concerns to foreign lenders can arise where such lenders own or acquire a material equity interest in a Canadian borrower, where they dispose of debt of a Canadian borrower to non-arm's length Canadian residents, or where they hold convertible debt of a Canadian borrower. Concerns can also arise in the event of a restructuring of Canadian-source debt or seizure of collateral. Canadian tax advice may be needed in such situations, as the issues and potential strategies will depend on the particular facts.

5. Guarantees and Security

5.1 Assets and Forms of Security

In Canada, all assets are generally available as collateral to lenders. In common-law provinces, security over personal property takes the form of a security agreement, which is perfected by registration with the provincial registry, or a pledge of investment property which may, in addition to perfection by registration, be perfected by control. Security over real property takes the form of a mortgage which is perfected by registration with the provincial land registry. Real property documents often require wet ink signatures. In certain provinces, the registration of a mortgage will be weeks after submission. Title insurance may be acquired to bridge the period for submission to registration. In Québec, incorporeal and moveable corporeal property are charged by hypothec which is registered with Québec's provincial registry. In Québec, immovable property is also charged by way of hypothec which is registered with a Québec land registry. A lender does not have a valid security interest unless it perfects its security interest. Personal property security can be taken quickly in Canada and costs are minimal compared to other jurisdictions.

5.2 Floating Charges and/or Similar Security Interests

All common-law provinces permit a security interest over a debtor's present and later-acquired

real and personal property. Québec permits a hypothec on the universality of a debtor's present and future property. Certain provisions also provide for a floating charge on real property.

5.3 Downstream, Upstream and Cross-Stream Guarantees

In Canada there are no limitations or restrictions on downstream, upstream or cross-stream guarantees, however certain business statutes require either notice or consent by the applicable shareholders.

5.4 Restrictions on the Target

A target company is not restricted from entering into guarantees, granting security or otherwise providing financial assistance for the acquisition of its own shares, unless the target later becomes insolvent and the use of proceeds of the acquisition is determined to be a fraudulent conveyance or preference.

5.5 Other Restrictions

Anti-assignment provisions are often found in government, licence, franchise, distribution, supply, joint venture and partnership agreements and may require the prior consent of the counterparty for a security interest to be taken in such agreement. Obtaining these consents may involve a considerable amount of time and expense. In certain provinces, the ability of an entity to hold a mortgage is limited to certain entities, however the use of a local collateral agent can address any issues.

5.6 Release of Typical Forms of Security

A lender or administrative agent will contractually release a guarantor from its guarantee and security obligations and discharge any security registration against the guarantor if the guarantor is required to be released under the loan documents. Similarly, loan agreements typically require a lender or collateral agent to amend its security registration to release specific assets of a loan party that are sold pursuant to a permitted disposition.

5.7 Rules Governing the Priority of Competing Security Interests

Priority is generally governed by order of creditor registration under the personal property security acts of the common-law provinces, although priority with respect to investment property is governed by control. Priority under the various real property registries is also governed by order of registration. Lenders may contractually vary their priority by entering into subordination and intercreditor agreements, which remain enforceable following the insolvency of a borrower.

5.8 Priming Liens

A lender's security interest is often primed by:

- a landlord's right of distress over a tenant's assets;
- a purchase money security interest over specific goods financed by a creditor;
- unfunded liabilities under a Canadian pension plan;
- Crown super priorities for employee income tax and payroll contributions;
- Crown deemed trusts for sales tax; and
- super priorities for up to USD2,000 of unpaid wages per employee.

A lender may have a landlord agree to subordinate its right of distress to the lender's security interest and may have a creditor agree to limit its purchase money security interest to specific financed goods. The other priming interests listed above cannot be contractually subordinated or limited although a loan agreement will usually have notice provisions and restrictions relating to these interests. There is recent case

law that certain environmental liabilities are paid prior to payments to a lender post insolvency. The courts are currently considering whether such environmental liabilities also need to be addressed pre insolvency.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Upon the occurrence of a default under the applicable security documentation, a secured lender can enforce its personal property security under provincial law (Personal Property Security Act (PSA) or similar legislation under each province) by providing notice of default and notice of its intention to foreclose upon or sell the collateral. In addition, in the case of real property, a secured party can enforce its security by way of a foreclosure action. If the collateral represents all or substantially all of the assets used in the business of an insolvent debtor, ten days' statutory notice must also be provided under Section 244 of the federal Bankruptcy and Insolvency Act (BIA). After expiry of the notice period set out in the BIA and the applicable PPSA or similar legislation, secured lenders can generally take possession of and sell the collateral directly or through an agent (eg, privately appointed receiver) or can apply to the court for the appointment of a receiver under the BIA.

6.2 Foreign Law and Jurisdiction

Assuming that the choice of foreign law is legally binding and enforceable under such foreign law, in any proceeding in a court of competent jurisdiction in Canada for the enforcement of a certain agreement, the Canadian court would apply the foreign laws, in accordance with the parties' choice of the foreign law in such agreement, to all issues chosen to be governed by the foreign law and which under local Canadian law are to be determined in accordance with the chosen law of the contract, provided that:

- the parties' choice of the foreign law is bona fide and legal and there is no reason for avoiding the choice on the grounds of public policy, as such term is interpreted under local Canadian law; and
- in any such proceeding, and notwithstanding the parties' choice of law, the Canadian court:
  - (a) will not take judicial notice of the provisions of the foreign law but will only apply such provisions if they are pleaded and proven by expert testimony;
  - (b) will not apply any foreign law and will apply local law to matters which would be characterised under local law as procedural;
  - (c) will apply provisions of local law that have overriding effect;
  - (d) will not apply any foreign law if such application would be characterised under local law as the direct or indirect enforcement of a foreign revenue, expropriatory, penal or other public law or if its application would be contrary to public policy; and
  - (e) will not enforce the performance of any obligation that is illegal under the laws of any jurisdiction in which the obligation is to be performed.

6.3 Foreign Court Judgments

A Canadian court applying common law or reciprocal enforcement of judgments agreements will generally give a judgment based upon a final and conclusive in personam judgment of the foreign courts for a sum certain, obtained against a borrower or guarantor with respect to a claim arising out of a credit agreement, without reconsideration of the merits,

- provided that:
  - (a) the court issuing a foreign judgment had jurisdiction over the borrower or guarantor as recognised under local law for the purposes of the enforcement of foreign judgments;
  - (b) an action to enforce a foreign judgment must be commenced in the Canadian court within the shorter of the applicable local limitation period or the applicable foreign law limitation period;
  - (c) the Canadian court has discretion to stay or decline to hear an action on a foreign judgment if such foreign judgment is under appeal or there is another subsisting judgment in any jurisdiction relating to the same cause of action;
  - (d) the Canadian court will render judgment only in Canadian dollars; and
  - (e) an action in the Canadian court on a foreign judgment may be affected by bankruptcy, insolvency or other laws affecting the enforcement of the rights of creditors generally; and
- subject to the following defences:
  - (a) a foreign judgment was obtained by fraud or in a manner contrary to the principles of natural justice;
  - (b) a foreign judgment is for a claim which, under local law, would be characterised as based on a foreign revenue, expropriatory, penal or other public law;
  - (c) a foreign judgment is contrary to public policy or to an order made by the Attorney General of Canada under the Foreign Extraterritorial Measures Act (Canada) or by the Competition Tribunal under the Competition Act (Canada) in respect of certain judgments referred to in these statutes; and
  - (d) a foreign judgment has been satisfied or is void under the foreign law.

6.4 A Foreign Lender's Ability to Enforce Its Rights

Foreign lenders should be cognisant of the requirement to have the security perfected under the laws of the Canadian province or territory in which the collateral is situated and for that perfection to be continued in the event that the collateral is moved to a different province or territory. Perfection is typically effected by registration under the applicable personal property security registry, but there are differences from province to province as to how security may be perfected in respect of different types of collateral. If the security is not perfected at the time the debtor becomes bankrupt, the security may be of no force or effect and the lender may become an unsecured creditor. In addition, the initiation of insolvency proceedings will generally stay a lender's rights to enforce its security unless the court lifts the stay to enable enforcement.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

A statutory stay of proceedings under the Bankruptcy and Insolvency Act (BIA) and a court-ordered stay under the Companies' Creditors Arrangement Act (CCAA) or in receivership proceedings will typically stay a lender from commencing or continuing an enforcement process against the debtor subject to the insolvency proceeding. The lender will typically have to seek leave of the court supervising the insolvency process to enforce its security or continue its enforcement action. The insolvency stay will not automatically prevent enforcement of a guarantee against a guarantor who is not subject to the insolvency proceeding, but the Court can extend the stay to such guarantors in a CCAA proceeding where it deems necessary to facilitate the restructuring.

7.2 Waterfall of Payments

On a company's insolvency, creditors are paid in the following order:

- certain "super-priority" government claims (eg, unremitted source deductions for payroll taxes);
- secured creditors to the extent of the value of their security over assets;
- preferred creditors in a bankruptcy (BIA Section 136), such as unpaid wages up to statutory limits and landlords for up to three months' arrears and three months' prospective rent if provided for under the lease; and
- unsecured (general) creditors.

In addition, certain payments in respect to environmental liabilities are paid prior to the payment of secured creditors.

7.3 Length of Insolvency Process and Recoveries

The length of insolvency processes varies based upon the complexity of the case. Simple bankruptcy and restructuring cases may be completed in a few months or less, whereas complex restructuring cases under the CCAA can last many years. Recoveries for creditors are typically more reliable within an insolvency process because a court officer (trustee, receiver, monitor) oversees the company's assets and recoveries.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Companies that are not insolvent can enter into arrangements with noteholders and other holders of securities pursuant to corporate law statutes, for example to exchange such securities for other securities, money or other property of the company. This would entail a plan of arrangement that is put to the affected securities holders to vote upon but would not be voted upon by other creditors generally.

7.5 Risk Areas for Lenders

The main risks are the lender being stayed from being able to commence or continue enforcement and inadequate assets being available to satisfy the indebtedness owed to the lender after taking into account any priority claims (eg, senior security or statutory priority claims). Canada has also recently enacted legislation to give priority to defined benefit pension plans in respect of unfunded liabilities and solvency deficits, subject to a four-year transition period (effective 27 April 2027). Recent case law has also resulted in certain environmental payments being paid prior to the payment of the secured creditors. The law surrounding these environmental payment amounts is evolving and subject to continuing litigation.

8. Project Finance

8.1 Recent Project Finance Activity

Project finance has been active across Canada particularly in the areas of infrastructure (eg, senior homes, hospitals, sustainable transportation) and renewables energy (including primarily solar, hydrogen and wind).

8.2 Public-Private Partnership Transactions

Public-private partnership (P3) transactions are utilised in Canada. The majority of P3 financings have occurred in Quebec, Ontario and British Columbia. In recent years, many financings are for the construction of a project, which on completion has a large government payment that is used to pay off the construction senior debt. The traditional P3 finance model, which is reliant on a government revenue stream to pay both costs

of construction and operations, also remains active in Canada, but with an added common approach to alternative or collaborative mode of delivery.

8.3 Governing Law

Proponents are able to utilise various laws for the various project documents depending on the parties' location, the location of the asset and the location and currency of the financing. As a general rule, there are no specific limitations on which laws should govern, although any documents relating to real property will generally be governed by the location of the land. Arbitration is rarely used for the finance documents but is occasionally utilised in the commercial documents.

8.4 Foreign Ownership

Foreign ownership may be limited under the Investment Canada Act or in respect to certain protected industries. In addition, certain provinces limit the amount of land outside of cities that may be owned by foreign entities. Entities subject to sanctions would also have ownership limitations or prohibitions. Canadian banks have a robust know your client and anti-money laundering regime applicable to all financings by the banks.

8.5 Structuring Deals

In structuring financing, the parties must consider ownership restrictions and laws specific to the type of asset. In many transactions, tax is a major influence on structuring decisions. Canada doesn't generally limit payments to offshore entities not subject to sanctions, but the payments may be subject to withholding taxes. The authors are seeing an increased focus on both indigenous consultation and investment/participation in respect of projects. Increased focus on inflation protection and risk protection, integrating benchmarking environmental protection and sustainability measures are also on the rise.

8.6 Common Financing Sources and Typical Structures

Typically, project finance is bond, bond/bank or bank only depending on the project and the term of the financing combined with an infusion of equity. Currently, there are various government programmes providing financing or grants for certain type of projects, often clean-energy based or based on sales outside of Canada, at the provincial and federal levels. In addition, the Canada Infrastructure Bank has been very active in providing financing to projects in their priority sectors being public transit, clean power, green infrastructure, broadband, and trade and transportation.

8.7 Natural Resources

Currently, other than restrictions under the Investment Canada Act, there are few limitations on the export of resources. See also the commentary in **8.4 Foreign Ownership** and **8.8 Environmental, Health and Safety Laws**.

8.8 Environmental, Health and Safety Laws

Canada has environmental laws at both the federal and provincial/territorial level that need to be complied with in respect to any project and its construction, operation and decommissioning. In certain cases, the laws require approval, reporting and/or monitoring. All provinces and territories have health and safety laws which are enforced by the applicable government.

Trends and Developments

Contributed by:
Mark Rasile, Karen Dawson, Noriko Shimura and David Rotchtin
Bennett Jones LLP

Bennett Jones LLP has a banking and finance group which routinely acts for leading domestic and foreign banks and financial institutions, as well as a deep, blue-chip roster of corporate and private equity sponsor clients. It is at the forefront of the market acting for alternative lenders, including managers of substantial institutional capital pools, direct private equity lenders and hedge fund debt investors in high-value, market leading mandates. It routinely advises on the structuring and documentation of domestic and cross-border syndicated and bilateral loan facilities, including leveraged acquisitions, takeover and tender bid financings, project financings, 1st/2nd lien structures, unitranche financings, complex intercreditor arrangements and restructurings (including some of the largest DIP loan facilities in the Canadian market). Its lawyers also offer clients a broad spectrum of legal and advisory services geared toward the changing needs and demands of the financial services industry. The firm has extremely close relationships with a number of senior regulators.

Authors

Mark Rasile helps clients of Bennett Jones LLP navigate the areas of lending and finance, both in private and public debt capital markets and through alternative credit sources and traditional commercial banks. Mark has broad experience advising on various types of financing transactions, routinely acting for a wide range of domestic and foreign credit providers, including banks and alternative lenders, borrowers and sponsors. He advises on both domestic and cross-border syndicated loan financings, acquisition and takeover bid financings, 1st/2nd lien structures, unitranche financing, complex intercreditor arrangements, workouts, restructurings, public and private bond offerings, and other debt capital markets transactions.

Karen Dawson is co-head of Bennett Jones LLP's banking and secured transactions group. She is a practical, client-service oriented financial services lawyer with extensive experience acting as lead counsel for lenders (institutional and private credit) and borrowers in a wide range of complex domestic and international finance transactions, including corporate lending transactions, acquisition financings, project financings, asset-based lending transactions, reserve-based lending arrangements, equipment financings and private placements. She also has broad experience working on restructurings (including the establishment of debtor-in-possession financing arrangements and foreclosures), and routinely advises as Canadian counsel in connection with complex cross-border financing arrangements.

Contributed by: Mark Rasile, Karen Dawson, Noriko Shimura and David Rotchtin, **Bennett Jones LLP**

Noriko Shimura has a broad financial services, corporate commercial law and aviation law practice within Bennett Jones LLP. She has experience representing borrowers and lenders in a wide range of domestic and international finance transactions (including unsecured and secured, both syndicated and bilateral financings, acquisition financings, project financings and asset-backed financings), and regularly advises clients on aircraft financing and leasing transactions and on aviation law matters. Noriko also advises Canadian corporations with business activities in Japan and liaises with Japanese companies entering the Canadian market.

David Rotchtin acts for lenders and borrowers on a variety of lending transactions. His experience includes syndicated loans, asset-based loans, cross-border loans, DIP loans, private bond placements, project financings, subordinated debt financings, acquisition financings and loan purchases. David aims to help his clients achieve their business objectives by bringing a practical and thoughtful approach to loan documentation. David's clients appreciate his ability to protect their interests while driving the lending transaction forward in a collaborative and considerate manner. His approach seeks to contribute to the respectful and honest relationship which is a cornerstone of a successful, long-term lending relationship.

Bennett Jones LLP

Suite 3400
1 First Canadian Place
Toronto
Ontario
M5X 1A4
Canada

Tel: +1 416 863 1200
Fax: +1 416 863 1716
Email: marketing@bennettjones.com
Web: www.bennettjones.com

Canada's Transition From Interbank Offered Rates

The global financial system has been moving away from using forward-looking interbank offered rates as reference rates to determine base interest rates. We have seen a shift towards overnight risk-free rates, as primary interest rate benchmarks in loans and other financial products. This is evidenced, for example, by the recent transition away from London Interbank Offered Rate (LIBOR). Canada is no exception to this global trend. Currently, the financial industry in Canada is in the midst of a benchmark transition, and is in the process of replacing the Canadian Dollar Offered Rate (CDOR) with a reference rate based on the Canadian Overnight Repo Rate Average (CORRA).

CDOR is determined daily from a survey of six market makers in bankers' acceptances (BAs), which include all of the largest charted Schedule I Canadian banks.

CDOR and Bankers Acceptances

In Canada, historically CDOR has been the primary interest rate benchmark for Canadian dollar loans. CDOR has to date been the recognized benchmark index for BAs with a term-to-maturity of one year or less.

A BA is a direct and unconditional order from a corporate borrower to draw down against its established BA credit facility at a Canadian bank. The lending (or the "accepting") bank then stamps the draft (the borrower's order), and by doing so, guarantees the principal and interest in the event of a non-payment by the borrower on maturity, at which time the draft becomes a BA. The discounted price paid by the bank to purchase the BA becomes the advance made available to the borrower under the BA facility. The lender (the accepting bank) also charges a fee called a "stamping fee" for providing such guarantee and becoming fully liable for the borrower's obligations. The stamped BA can then be sold by the accepting bank in the secondary market, or kept by the accepting bank for its own account. While traditional BAs were paper based, the banks have since adopted electronic settlement of BAs (thus eliminating paper form BAs). Canada is the only major jurisdiction that has kept BAs as a loan funding tool.

CDOR is not a borrowing rate for banks. Rather, it is a rate at which lenders are willing to commit (ie, "offer") to make loans to their corporate clients (ie, corporate borrowers that have already established BA facilities with such lenders) against BA issuances with terms of approximately one, two and three months.

While CDOR is used for its initial purpose, it had also been used in Canada as the interest rate benchmark in floating-rate notes, and in Canadian dollar-denominated derivative products.

Cessation of CDOR after 28 June 2024

On 16 May 2022, the administrator of CDOR, Refinitive Benchmark Services (UK) Limited (RBSL), announced that it will permanently cease the publication of all remaining tenors of one-month, two-month and three-month CDOR following the last CDOR publication on 28 June 2024. There will be no successor administrator of CDOR.

To set clear expectations for the financial industry to transition away from CDOR, the Canadian Alternative Reference Rate Working Group (CARR), with representatives from the Canadian financial market including the Bank of Canada, published transition timelines that include the following milestones:

- after the end of 30 June 2023 – there should be no new CDOR usage for derivatives or securities (with limited exceptions);
- after 1 November 2023 – no new CDOR or BAs-related loans should be offered by banks; and
- after 28 June 2024 – as previously announced, there will be no more CDOR publication by RBSL or any other person.

Upon the cessation of CDOR publication, it is expected that the Canadian banks will cease "stamping" BAs or, in other words, making BA loans to its customers under existing BA facilities.

Publication of a Canadian dollar forward-looking, risk-free rate (Term CORRA)

The overnight risk-free rate that is replacing CDOR is CORRA. CORRA is based on the overnight repurchase transactions using government of Canada securities as collateral. CORRA is based on actual transactions and is considered a more robust and transparent interest rate benchmark than CDOR. Bank of Canada is the administrator of simple CORRA.

Given that CORRA is a daily rate, the Canadian financial sector has been advocating for the development of a forward-looking term CORRA rate, so that such term rate can function in the same manner as CDOR and be a substitute for CDOR in loan documents. The need for such term rates is consistent with what the financial market has seen in other jurisdictions (such as Term SOFR being developed in the United States, in the face of LIBOR cessation). In response to such demand, Term CORRA rates for one-month tenors and three-month tenors have been developed. CanDeal Benchmark Administration Services Inc was selected as the administrator of Term CORRA, and has recently commenced publication of the one-month and three-month Term CORRA rates, in collaboration with TMX Datalinx.

Term CORRA rates are calculated for each day the Bank of Canada calculates and publishes CORRA, and are published at 13:00 Eastern Standard Time. To access the published Term CORRA rates on a real-time or same-day basis, users are required to enter into licensing agreements; however, Term CORRA rates for the prior business day can be viewed publicly, at 16:00 Eastern Standard Time, on the following business day.

Impact on loan documents

In light of the global transition away from LIBOR, lenders and borrowers have seen a rapid flurry of amendments being made to existing loan agreements that provide for US-dollar denominated loans. Such credit agreement amendments took place in two phases.

- The purpose of the initial amendments was to incorporate a detailed benchmark transition clause into existing credit agreements, in order to prepare for any future benchmark cessation (including LIBOR cessation), and provide certainty around how the applicable interest rate would be determined in such instance under existing loan arrangements. This was important to ensure that the borrowers were able to continue to access funds under previously negotiated and established credit facilities. Such benchmark replacement provisions are also included in new credit agreements. These benchmark replacement provisions are typically "hard-wired", meaning the provisions explicitly identify what the replacement benchmark will be when the first benchmark replacement occurs (and a cur-

rently used benchmark becomes permanently unavailable) in the future.
- The second stage of the loan agreement amendments were to specifically include replacement benchmark loans (such as Term SOFR loans in a US dollar denominated credit facility) as an availment option under existing credit facilities.

Existing credit agreements that provide for Canadian dollar loans may already contain a robust benchmark replacement clause. However, such clauses would not have a "hard-wired" Canadian dollar replacement benchmark (and not specifically set out the Canadian dollar benchmark that will replace CDOR) or any applicable spread adjustment when CDOR is replaced. Accordingly, existing loan documentation will require CDOR-specific amendments to existing benchmark replacement language to address the impending CDOR cessation.

In August of 2022, CARR published recommended benchmark replacement language (the "2022 CARR Language") for Canadian dollar loans to include in loan agreements. The 2022 CARR Language was made publicly available in anticipation of the publication of Term CORRA rates in the third quarter of 2023, and sets out the recommended credit spread adjustment to be added to the base Term CORRA rate. Since the 2022 CARR Language was published, the Canadian financial market has seen such language adopted and incorporated widely into new credit agreements or into existing credit agreements via amendments, while we have seen some lenders hold off on adopting the 2022 CARR Language (awaiting the publication of Term CORRA Rates). However, now that Term CORRA rates are available, we expect less hesitancy from lenders around the "hard-wiring" of Canadian benchmark replacements in loan documents. To date, financings which have adopted the CDOR hardwired fallback terms of the 2022 CARR Language have closely tracked those model terms, including with respect to the recommended credit spread adjustments, and there has not yet been significant market movement off of those model terms, as was seen for example in the case of the ARRC LIBOR fallback language.

At the end of July 2023, CARR also published CORRA loan agreement definitions and loan agreement provisions (the "2023 CARR Language"), in anticipation of the publication of Term CORRA rates commencing in September 2023. The 2023 CARR Language provides for Term CORRA loans as a built-in availment option under a credit agreement. Given that the publication of Term CORRA rates has begun, we anticipate that lenders will start offering Term CORRA-based Canadian dollar loans, shortly. Lenders may incorporate the 2023 CARR Language with minimal change or, where possible, may be able to simply include Term CORRA as one of the availment options under existing loan mechanics.

Upon CDOR cessation, it is expected that Canadian banks will stop accepting requests for BA loans under any existing BA facilities. Some lenders have been removing BA-specific provisions from existing credit agreements, and are no longer including BAs as an availment option under new credit agreements. Given the 1 November 2023 milestone set by CARR, we expect the transition away from offering new BA facilities will accelerate.

Unlike some other jurisdictions, there is no specific legislation being enacted in Canada in connection with the cessation of CDOR. In anticipation of the CDOR transition, it is imperative

that any credit agreement under which BA loans or CDOR loans are being offered be reviewed by the parties thereto to (i) ensure that there is a clear benchmark replacement mechanism in place to replace CDOR with the desired CORRA-based benchmark and (ii) identify whether loan mechanics need to be updated in connection with CDOR cessation. If, for example, an existing credit agreement only includes an option for BA loans (and no other term loan options currently exist under such credit agreement), conforming changes to the loan mechanics will be required in order to make Term CORRA loans available under such credit agreement.

Going forward, and as we approach the 28 June 2024 CDOR cessation date, we expect to continue to see amendments related to Canadian benchmark replacements be a key consideration on amendments to existing Canadian dollar financings, and any new money financings to include built-in Term CORRA availment mechanics.

Private Credit in Canada – Energy Sector and Beyond

Like their US-based counterparts, Canadian oil and gas companies have traditionally been financed through chartered bank-provided, reserve-based credit facilities, high-yield debt issuances and preferred and common equity investments. Ongoing economic uncertainty, tighter lending requirements and bank prioritisation of environmental, social and governance matters have made it difficult for some oil and gas companies to procure the new money loans required to effect acquisition strategies, and to ensure the continuity of right-sized credit facilities for day-to-day operations. The ongoing higher interest rate environment is further exacerbating financing concerns in the energy industry, with overall costs of borrowing increasing to unsustainable levels for some producers, energy service companies and midstream operators.

While the largest Canadian banks remain supportive of strong energy industry credits, in particular the Canadian oil majors, some Canadian junior and mid-market oil and gas companies are finding it increasingly necessary to seek alternative sources of debt financing. Companies looking to fund energy transition initiatives and related project builds are also, out of necessity, looking for capital and innovative deal structuring in unconventional arenas. There have been a handful of alternative lenders that have developed in-house oil and gas expertise and cater to providing financing, primarily in the lower middle market, to the energy sector. However, while there has been much commentary and discussion around a need to find non-traditional financing sources to supplement the Canadian banks in the reserve-based lending space, the largest Canadian banks continue to be the primary source of funding to the sector.

More generally, there has been a steady growth of alternative lenders and private credit originating and transacting on new financings in the middle and lower-middle market segments of the Canadian loan market. What has driven the growth in this space is no different than the catalysts behind the emergence of alternative lenders in other jurisdictions – growth of private credit as an asset class, fewer regulatory constraints on such lenders as comparted to regulated banks, more flexible and nimble terms on offer than in traditional bank financings, among a long list of other factors. There has, for some time, also been a number of domestic non-bank credit providers that focus on special and distressed opportunities.

While certain of the largest Canadian pension funds have increasingly made direct lending a meaningful part of their business and investment portfolio, and are active players in the higher-value, private credit markets in other jurisdictions, that has not yet translated into those institutions building a significant presence or position in our domestic loan market. There are few examples of larger alternative lenders having provided, either unilaterally or together with a small "club" of similar alternative lenders, larger value financings in the Canadian market.

When looking at the full landscape of the Canadian loan market, alternative and direct lenders have not yet had the same impact or success as they have in the US in displacing or supplementing our largest banks. While it is not uncommon to see US PE direct lenders financing M&A that has a material Canadian component, or that may be specifically in respect of a Canadian target, that is most often in the context of a US buyer calling on its preferred financing sources to support the "Canadian M&A" opportunity. Canadian banks continue to be the overwhelmingly dominant financing source in our mid and upper tier loan markets, particularly in higher-value leveraged financings that are arranged and provided solely by domestic lenders.

CHINA

Law and Practice

Contributed by:
Ma Feng, LV Yinghao, Xiaoxue (Stella) Wang and Qiu Liang
King & Wood Mallesons

Contents

King & Wood Mallesons has an award-winning and independently recognised banking and finance legal team, which is active in finding innovative finance solutions for the market's most complex and sophisticated transactions. The team of almost 30 partners and more than 130 associates is at the forefront of this highly evolving market, handling banking and finance transactions across Greater China and providing clients with the latest industry insights and know-how. It offers comprehensive legal services across the full spectrum of financial products, including aircraft/vessel and other asset financing/leasing, project financing, M&A financing, trade finance, real estate financing, pre-IPO and privatisation financing, syndicated loans, debt capital markets, asset-backed securitisation and structured finance, non-performing asset sale and purchase, debt restructuring (out of court), derivatives, fintech, bank card clearing and third-party payment.

Authors

Ma Feng is a partner at King & Wood Mallesons. Ma Feng specialises in banking, domestic and international lending, project financing, M&A financing, asset financing and leasing, and establishment and risk mitigation of financial institutions. Ma Feng provides a full range of services to domestic and overseas lessors, financiers and airlines in financing and leasing of aircraft, ships and equipment. Ma Feng also represents clients in investments in and establishment of various financial institutions including commercial banks, financial leasing companies, and auto financing companies. With extensive experience with financial institutions, Ma Feng assists financial institutions in formulating and implementing targeted risk mitigation solutions to existing and potential challenges, and improving their internal governance.

LV Yinghao is a partner at King & Wood Mallesons. Yinghao specialises in banking and finance and represents international and Chinese commercial banks, investment banks, investment funds and industrial businesses in a wide variety of financing transactions, with a particular focus on project financing, acquisition finance, trade finance and asset finance. Yinghao has acted for clients in transactions across mainland China, Hong Kong, Southeast Asia, Africa, Australia, Europe and Latin America, where the projects involve minerals, energy, power, infrastructure manufacturing, agriculture, hospitality and information technology sectors. His extensive experience and innovative expertise have won him wide acclaim from his clients.

Xiaoxue (Stella) Wang is a partner at King & Wood Mallesons. Xiaoxue specialises in banking and finance and has provided all-round legal services for many domestic and foreign-funded banks and other financial institutions, including regulatory advice and financing transactions, such as syndicated loans, real estate financing, structured trade financing, pre-listing financing, and privatisation financing. Xiaoxue has also acted for private equity funds, real estate funds, multinational corporations, and state-owned enterprises on their M&A financing transactions. Xiaoxue also has extensive experience in providing legal and regulatory advice to foreign credit funds and asset management companies. She has advised a number of foreign institutions on their debt or equity investment in China via QFII, CIBM Direct, QFLP channel, etc.

Qiu Liang is a partner at King & Wood Mallesons. Qiu Liang specialises in banking and finance, focusing on general banking business, project financing, M&A financing, structured financing, real estate financing, disposal and restructuring of non-performing assets, trade financing, domestic and international syndicated loans, asset financing, financial leasing, foreign exchange and financial derivatives etc. Qiu Liang has represented domestic and international banks, syndicates, state-owned enterprises, joint ventures, project companies and other clients in a number of project financings and "Belt and Road" projects, involving industries including wind power, thermal power, photovoltaics, mining, and manufacturing.

King & Wood Mallesons

18th Floor
East Tower
World Financial Center
No.1 Dongsanhuan Zhonglu
Chaoyang District, Beijing 100020
P. R. China

Tel: +86 10 5878 5588
Fax: +86 10 5878 5566
Email: markets@cn.kwm.com
Web: www.kwm.com/zh/cn

金杜律师事务所
KING&WOOD
MALLESONS

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

The National Development and Reform Commission of the PRC (NDRC) published the Administrative Measures for the Review and Registration of Medium and Long-Term Foreign Debt of Enterprises (企业中长期外债审核登记管理办法) (Fa Gai Ling [2023] No 56) on 5 January 2023 (the "Measures"). Compared with the previous circular published by the NDRC in 2015, the new Measures strengthen the requirements on foreign debt by, inter alia:

- introducing the concept of "indirect foreign debt" which encompasses round-chip companies whose main assets are located on the mainland; this raises questions about whether foreign fund managers would require NDRC approval for borrowing offshore to invest in mainland assets; and
- stipulating a three-month period for NDRC review, contingent on satisfactory application documentation; as NDRC approval is mandatory before the first drawdown, timing has emerged as a significant concern, particularly for refinancing deals, so parties involved should factor this duration into their financial planning.

China's real estate market has not recovered as expected. Although existing financial measures appear favourable on the surface, they disproportionately benefit top-tier real estate firms. Consequently, the broader financing environment for the real estate sector remains decidedly challenging. Moreover, several real estate enterprises are on the brink of delisting, exacerbating a vicious cycle caused by a lack of market confidence and cash flow difficulties. Against the backdrop of ongoing industry risks and with market confidence not yet fully restored, the majority of private real estate enterprises still face challenges regarding difficult and expensive financing, which remain to be addressed.

In a global context, the U.S. Federal Reserve has repeatedly increased the dollar interest rate over the past year. In contrast, the People's Bank of China has been actively reducing the RMB interest rate to stimulate the domestic economy. Consequently, there has been a notable shift away from offshore financing in favour of onshore RMB loans.

1.2 Impact of the Ukraine War

In loan transactions, specific situations (such as involvement in sanctioned industries or the possibility of individuals controlling parties on sanction lists) are given heightened attention. Additional due diligence is often conducted to ensure that potential risks associated with relevant transactions are fully identified and assessed. Lenders shall also pay closer attention to sanction-related representations and warranties clauses within loan documents.

The Ukraine war is also having an impact on currency exchange rates, especially for countries directly involved in or with significant economic exposure to the conflict. Fluctuations in exchange rates can influence the terms and costs of loans, especially for entities dealing with foreign currency-denominated debt.

During periods of heightened geopolitical tension, lenders might become more selective in approving loans. This could result in reduced credit availability for businesses and individuals. Lenders may prioritise loans with lower default risk or collateralised assets.

1.3 The High-Yield Market

With the bounce back of the PRC economy, several PRC-incorporated companies have returned to the bond market and continue to sell successful deals in different currencies. Whilst high-yield debt issues have yet to become a vital alternative financing source within the domestic PRC market, the overseas markets (including Hong Kong) continue to see robust demand for PRC or PRC-sponsored issues.

1.4 Alternative Credit Providers

The alternative credit industry offers a lot of opportunities but is also subject to more stringent supervision in the PRC, which may continue for a relatively long time. For example, the regulatory authorities have introduced a series of policies to encourage the development of consumer finance in the past few years. Favourable policies such as lowering the coverage ratio requirement will effectively improve consumer finance companies' profitability and risk mitigation capabilities, and allowing consumer finance companies to carry out the transfer of credit income rights at the banking credit asset transfer registration centre will help them to further expand financing channels and business volume.

A similar trend has been observed in different kinds of alternative credit industries. The increase in financing demands of companies on the supply chain stimulates not only banks granting regular loans, but also factoring companies focusing on supply chain financing. In the context of the country's emphasis on internal circulation, the development of the alternative credit industry can effectively stimulate domestic demand. The favourable regulatory policies have greatly helped to build up confidence in the industry.

Several credit funds and other kinds of alternative credit providers have also participated in the direct foreign debt to be granted to companies located in China, or invested in the non-performing loan market.

1.5 Banking and Finance Techniques

Following the COVID-19 pandemic, both borrowers and lenders now tend to use more comprehensive forms of term sheets or commitment letters to avoid disputes or arguments during the documentation stage. Compared to the period prior to the COVID-19 pandemic, borrowers and lenders now have a deeper understanding of the establishment and application of the level of consent required for specific matters, grace periods used in undertakings and event of default clauses, force majeure and other similar carve-out clauses.

With the Civil Code of the PRC coming into force at the beginning of 2021, officially confirming the security nature of non-standard security (such as assignment of rights or subordination of inter-company loans), there is now more flexibility for relevant parties to negotiate the credit support arrangement and to be more creative in this area.

1.6 ESG/Sustainability-Linked Lending

The PRC authority is stepping up efforts to promote the development of green loans. The green finance guidelines for the banking and insurance industries have been issued, requiring banks and insurers to:

- increase support for the green, low-carbon and circular economy;
- include ESG requirements into their management processes and comprehensive risk management systems;
- strengthen ESG disclosures; and

- improve relevant policies, mechanisms and process management.

Meanwhile, the regulatory body is actively fostering product innovation by advocating the expansion of green loan initiatives. Additionally, the authority is inclined to steer local lenders towards augmenting their allocation of resources for green loans.

Driven by policy encouragement, PRC banks are actively seizing the opportunities presented by the development of green finance, which has become a new growth point for them. Looking at the annual reports of various PRC banks, it is evident that green loans are experiencing rapid growth, with growth rates exceeding 30%, becoming a common trend. In addition to the high growth of green loans, banks are also introducing innovative green financial products and services. Simultaneously, banks are comprehensively advancing the development of green finance in terms of organisational structure, policy frameworks, and other aspects.

2. Authorisation

2.1 Providing Financing to a Company

Any entity (including banks and non-banks) may provide loans to another company in the PRC. However, carrying out a "lending business" (ie, providing loans on a regular basis) in the PRC is restricted to financial institutions or quasi-financial institutions with lending licences granted by the relevant financial sector regulator (eg, banks, micro-lending companies). It often requires specific case-based analysis to determine whether someone is running the risk of conducting a "lending business" without the appropriate licence.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

A foreign lender who makes a cross-border loan to a PRC company is not required to be licensed in the PRC. However, it is worth noting that:

- a PRC company that intends to borrow loans from a foreign lender must have a sufficient quota for borrowing loans from foreign lenders (the so-called foreign debt quota); and
- the loans borrowed by a PRC company from any foreign lender shall be subject to registration with the State Administration of Foreign Exchange of the PRC (SAFE) and (if the tenor of such loans is more than one year) registration with the NDRC.

On a related note, the People's Bank of China (PBOC) and SAFE jointly published a regulation in February 2022 to govern offshore lending provided by PRC banks to offshore entities, which imposes a series of restrictions on lending limits, loan purposes, eligible borrowing entities, and data reporting requirements, etc.

3.2 Restrictions on Foreign Lenders Receiving Security

There are no specific restrictions on the receiving of security or guarantees to foreign lenders. However, any security or guarantees granted by a PRC company to foreign lenders which is to secure the liabilities of a debtor incorporated or organised outside the PRC (commonly known as "Nei Bao Wai Dai") shall be registered with SAFE.

3.3 Restrictions and Controls on Foreign Currency Exchange

There are restrictions and controls on foreign currency exchange in the PRC. The PBOC and SAFE are the main authorities in charge of for-

eign exchange controls in the PRC. Generally, foreign exchange activities in the PRC are divided into two categories, namely current account activities and capital account activities.

Foreign exchange transactions relating to capital account activities (eg, borrowing from, and granting of security or guarantees to, foreign lenders) are more heavily regulated and more strictly controlled than those relating to current account activities and shall generally be subject to approval by or registration/filing with SAFE.

3.4 Restrictions on the Borrower's Use of Proceeds

Generally, the proceeds from loans or debt securities could be used for various purposes, including but not limited to investment in fixed assets, working capital purposes and acquisitions. That said, the proceeds from loans or debt securities borrowed or issued by a PRC company outside the PRC shall in principle be used for the purposes falling within the business scope of such PRC company registered with the State Administration for Market Regulation of the PRC.

3.5 Agent and Trust Concepts

The concept of agent is recognised under PRC law, pursuant to which the agent may act for and on behalf of the principal(s). The concept of trust under the PRC law (which means that the settler entrusts his/her/its property rights to the trustee and allows the trustee to, according to the will of the settler and in the name of the trustee, administer or dispose of such property in the interests of a beneficiary or for any intended purposes) is not applicable to the holding of security by the security agent for and on behalf of the lenders and therefore is not commonly used in the loan market.

3.6 Loan Transfer Mechanisms

A loan transfer is essentially the transfer of contractual rights under PRC law required to effect such transfer. In general:

- a loan transfer will become effective between the transferor and the transferee from the date of the execution and completion of the loan transfer between these two parties;
- once the loan is transferred, the benefit of the associated security or guarantees shall be automatically transferred together with the loan; and
- the loan transfer will become effective against the relevant borrower/security provider/guarantor as from the date on which such borrower/security provider/guarantor is notified of such loan transfer.

The transfer of loans is also subject to certain regulatory requirements (eg, partial transfer of a loan by banks is currently not permitted) and foreign exchange control (eg, a PRC lender may not transfer the loans made to a PRC company to a foreign lender without the approval of SAFE).

3.7 Debt Buy-Back

PRC law does not prohibit a borrower or sponsor from buying back debt. Debt buy-backs are subject to the regulatory requirements and foreign exchange control on loan transfers. Contractual restrictions are often put in place where the buy-back is partial only.

3.8 Public Acquisition Finance

In the case of the acquisition of a company listed in the PRC, the financial consultant of the buyer is required by regulators to ensure that the buyer has the capability to perform its obligations under the acquisition transaction, but there is no PRC law, regulation or rule regarding "certain funds" with respect to the loan facility

used to finance the public acquisition finance transactions. There is also no uniform standard regarding the "certain funds" provisions in the acquisition finance transactions in the PRC. The "certain funds" provisions could be agreed between the borrower and lender by themselves. In practice, loan documents will often include certain funds provisions which are comparable to those to be found in the documentation of an international acquisition finance transaction.

3.9 Recent Legal and Commercial Developments

Following the promulgation of the NDRC Measures as mentioned above, from the legal documentation perspective, we should pay attention to the update of the terms (including, without limitation, definitions, representations and warranties, undertakings, conditions precedent and conditions subsequent) of the facility agreements. According to the Measures, lenders will require that borrowers obtain a Registration Certificate as a condition precedent for drawdown, and will impose more specific obligations to ensure borrowers' compliance with the Measures.

After a decade of preparation, the LIBOR transition has entered its final stage. The end of June 2023 marked the final major milestone in the LIBOR transition with the end of the remaining USD LIBOR panel. A large number of loan agreements that used to apply LIBOR have also modified their interest rate benchmarks in the form of amendment and supplemental agreements.

3.10 Usury Laws

Under PRC law, the rate of interest that can be charged by the lender that is not a financial intuition or quasi-financial institution with a lending licence shall not exceed four times the one-year Loan Prime Rate prevailing as of the date of the loan agreement. There is no law or other rule limiting the amount of interest that can be charged by financial institutions or quasi-financial institutions with a lending licence.

3.11 Disclosure Requirements

The PRC has a range of laws and regulations governing financial contracts and their disclosure, including but not limited to:

Securities Law

The Securities Law of the People's Republic of China (中华人民共和国证券法) governs the issuance and trading of securities in the PRC. It includes provisions related to disclosure requirements for publicly-traded companies. These companies are required to disclose financial information, business operations, risks, and other relevant information to ensure transparency for investors.

Stock Exchanges

Companies listed on Chinese stock exchanges, such as the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE), must adhere to specific disclosure requirements set by these exchanges. These requirements include regular financial reporting, announcements of major events, and more.

Interbank and OTC Markets

In China, there are also interbank and over-the-counter (OTC) markets where financial products are traded. Depending on the type of financial contract and market, there may be specific disclosure requirements set by the regulatory authorities.

Banking and Insurance

Financial contracts in the banking and insurance sectors are subject to regulations from China's National Financial Regulatory Administration (NFRA). These regulations include provisions

for disclosure of financial information, terms and conditions of financial products, and risk-related information.

Online Finance

In recent years, China has also seen a growth in online finance and fintech platforms. These platforms are subject to specific regulations aimed at ensuring transparency, consumer protection, and preventing financial risks.

Foreign Investment

Foreign investors engaging in financial contracts in China should also be aware of any specific regulations and disclosure requirements that apply to their investments.

Anti-Money Laundering (AML) Regulations

Financial institutions operating in the PRC are also subject to AML regulations, which may include disclosure requirements related to suspicious transactions and customer due diligence.

4. Tax

4.1 Withholding Tax

No withholding tax is payable in the PRC in respect of payments of principal, interest or other payments made by a PRC company to lenders incorporated or organised in the PRC.

However, PRC income tax (currently set at rate 10%), value added tax (currently set at rate 6%) and surcharges are applicable to payment of interest and fees made by a PRC company to non-PRC resident lenders, subject to adjustment by applicable treaty. Such taxes would be withheld by the PRC company acting as the obligatory withholder on the payments to the non-PRC resident lenders.

4.2 Other Taxes, Duties, Charges or Tax Considerations

In the case of loans extended by a PRC resident lender to a PRC company, value added tax (currently set at 6%) along with associated surcharges will be levied on interest and fee payments, and the PRC resident lender is obligated to pay PRC income tax (currently set at 25%) on an annual basis for its profits. Concerning interest and fee payments made by a PRC company to non-PRC resident lenders, the taxes apply by way of withholding.

No stamp duty or taxation of a similar nature is payable in the PRC in respect of the execution of security documents or guarantees. Stamp duty in respect of loan agreements is required to be paid by the borrower and the lender respectively at the rate of 0.005% of the loan amount (to the extent that such lender is a financial institution).

4.3 Foreign Lenders or Non-money Centre Bank Lenders

As set out in **4.1 Withholding Tax**, interest and fees paid to foreign lenders will be subject to PRC income tax, value-added tax and surcharges, by way of withholding. As a mitigation measure, a tax indemnity clause will be incorporated into the loan documentation.

Whether or not a lender is a non-money centre lender will not result in differences in terms of tax considerations in the PRC.

5. Guarantees and Security

5.1 Assets and Forms of Security

Overview

The following assets and forms of security are widely adopted by lenders in the loan market:

- mortgage over immovable assets, including real property and construction land-use rights;
- mortgage over movable assets, including machinery, equipment, goods and raw materials, vehicles, aircraft and ships;
- pledge over movable assets; and
- pledge over rights and benefits, including shares and equity interest, deposits, bank accounts, receivables, etc.

Perfection Requirements

Mortgage over immovable assets

A security interest will be created once it is registered with the competent public register. For instance, a mortgage over real property will be created upon the completion of registration with the Real Estate Registration Centre of the Ministry of Natural Resources.

Mortgage over movable assets

A security interest will be created once the mortgage agreement is duly executed by the parties; such security interest cannot be claimed against any bona fide third party without registration.

Pledge over movable assets and financial instruments

A security interest will be created from the date of delivery of such movable assets, and the title certificate of bills of exchange, promissory notes, checks, bonds, certificates of deposits, warehouse receipts or bills of lading. For a pledge over financial instruments, in the absence of a certificate, a pledge will be created upon the completion of registration with the competent authorities.

Pledge over rights and interest

For a pledge over shares and equity interest, or intangible assets such as intellectual property and receivables, the security interest will be created upon registration with the competent authorities.

Unified Registration of Security Created Over Movable Property and Rights

Since 1 January 2021, the relevant parties can access the Movable Property Financing Unified Registration and Publication System of the Credit Reference Centre to register the following types of security:

- mortgage of production equipment, raw materials or semi-finished products;
- pledge of receivables;
- pledge of deposit certificates, warehouse receipts or bills of lading;
- finance lease;
- factoring;
- title retention; and
- other registrable security created on movable property and rights, but excluding the mortgage of vehicle, ship or aircraft and the pledge of bond, fund shares, equity interest and property rights of the intellectual property.

Timing

Although there is no specific time requirement for all such registrations, it is advisable for lenders to require the obligors to complete the formalities as soon as reasonably practical, to ensure the creation of the security interest, ranking in priority and right against the bona fide third party.

Stamp Duty

Security documents are not subject to stamp duty or other taxes of a similar nature in the PRC.

Registration Fees

Depending on the type of security interest, some registrars may charge a registration fee, either

based on the value of the collateral or as a lump sum, although such registration fees are not substantial.

5.2 Floating Charges and/or Similar Security Interests

Under PRC law, a floating mortgage can be created over the mortgagor's current and future manufacturing machinery and equipment, raw materials, semi-finished products and products.

Before crystallisation, the floating mortgage will not restrict the mortgagor's right to dispose of the mortgaged assets. Crystallisation will occur under the following circumstances:

- non-payment by the debtor;
- the mortgagor is declared insolvent or dismissed;
- any event as mutually agreed by the parties to realise the mortgage; and
- other circumstances that have a severe impact on the realisation of the secured indebtedness.

Exception to Priority in Ranking

Where an asset falling within the scope of the floating mortgage has been purchased by a purchaser at a reasonable price through the mortgagor's normal business activities, the security interest created on that asset cannot be claimed against the right of the purchaser.

For those assets of the mortgagor that are purchased or leased by way of finance lease after the creation and registration of the floating mortgage, where any mortgage or similar security is created over those assets to secure the consideration or rent payable and is registered within ten days after the delivery of that asset, the following interests will rank prior to the floating mortgage:

- the mortgage created in favour of the seller and the right of the seller in the title retention arrangement;
- the mortgage created in favour of the creditor financing the consideration; and
- the right of the lessor who leases that asset by way of lease.

5.3 Downstream, Upstream and Cross-Stream Guarantees

Downstream, upstream and cross-stream guarantees are generally permissible under PRC law, provided that the guarantor has taken all necessary corporate actions to authorise the execution of the guarantee.

As for the provision of upstream guarantees to guarantee the liabilities of a shareholder or ultimate controller, the shareholders' resolutions of the guarantor shall be required. If such guarantor has more than one shareholder, the principal-debtor shareholder, or the shareholder that is controlled by the principal debtor/ultimate controller, shall have no voting rights in the passing of the relevant shareholders' resolutions.

Special Requirement for Listed Company

For a listed company incorporated in the PRC (or any of its material subsidiaries that have been disclosed), the provision of security and guarantees must be evidenced by a relevant public announcement in relation to the passing of internal resolutions. In the absence of such public announcement, the listed company or its material subsidiaries may claim against the creditors on the validity of such security and guarantees in legal proceedings.

Special Requirement for State-Owned Enterprises

Where a state-owned enterprise is to provide security or guarantees for its subsidiaries, it may

be subject to a requirement that the portion of liabilities secured or guaranteed by it does not go beyond the proportion of its shareholding in that subsidiary. Moreover, under certain circumstances, approval from or filing with the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) will be required, pursuant to regulations or guidelines promulgated by SASAC or its local branch.

On 9 October 2021, SASAC promulgated the Circular on Strengthening the Administration of Central Enterprises' Providing Guarantee and Security (the "Circular") to regulate the provision of guarantees and security of central enterprises. In this Circular, it is made clear that:

- An implicit guarantee (co-borrowing contract, deficiency supplement commitment, comfort letter, etc) shall also be regulated as a guarantee, insofar as it has the effect of a guarantee.
- Central enterprises are strictly prohibited from providing guarantees and security in any form to secure the obligations of enterprises that:
  (a) are outside the group and have no equity relationship with such central enterprise;
  (b) have entered into reorganisation or bankruptcy proceedings;
  (c) are insolvent;
  (d) have been suffering losses for no fewer than three consecutive years; and
  (e) are financial institutions.
- Central enterprises should strictly control the extent of guarantee and security provision so that such provision does not exceed 40% of the consolidated net assets of the group. Furthermore, for any individual central enterprise or any of its subsidiaries, the guarantee and security provision limit is capped at 50% of the net assets of such enterprise. The total provision of security and guarantees for the financing of an enterprise included in the annual debt risk control scope of SASAC shall not increase compared with the previous year.
- Central enterprises should strictly control the provision of guarantees/security that exceeds the proportion of shares held. In principle, a central enterprise can only provide a guarantee or security to its subsidiaries and enterprises in which it holds shares strictly in accordance with the proportion of shares it holds in such enterprises. Where it is necessary to exceed the proportion, this shall be reported to the board of directors of the group for approval. Also, for the guaranteed/secured amount exceeding the proportion of shares, counter security with sufficient and realisable value shall be provided by a minority shareholder or a third party through a mortgage, pledge or other means.

5.4 Restrictions on the Target

It is generally acceptable for the target to provide security, guarantees or financial assistance in favour of the acquirer in an acquisition transaction, subject to the conditions discussed in **5.3 Downstream, Upstream and Cross-Stream Guarantees** in respect of upstream guarantees.

5.5 Other Restrictions

There is a particular requirement for the provision of cross-border security or guarantees – please see **6.4 A Foreign Lender's Ability to Enforce Its Rights**.

5.6 Release of Typical Forms of Security

Security will be released upon:

- the discharge of secured liabilities;
- the realisation of the security;
- the secured creditor waiving its interest over the collateral; or

- the occurrence of other circumstances under which the security will be discharged as prescribed by law.

In practice, for the purpose of deregistration with the relevant registration authority, the parties will enter into a bilateral release agreement or the secured creditor will issue a confirmation letter to the security provider, confirming the release of the security interest, based on which the security provider can request the relevant registration authority to process the deregistration.

5.7 Rules Governing the Priority of Competing Security Interests

Competing Security Interests

Rules for competing mortgages/pledges

Where there are multiple mortgages/pledges created over a collateral, the priority will be determined as follows:

- by the registration order if all security interests have been registered;
- where some security interests have been registered while some remain unregistered, the registered interests shall rank in priority to the unregistered ones; and
- where no registration has been made, all interests shall rank in the same sequence and proceeds obtained through auction or sale of collateral shall be applied towards payment pro rata of all secured indebtedness.

Rules for competing mortgages and pledges

Where both a mortgage and pledge are created over a collateral, the priority will be determined by order of registration of the mortgage, and delivery of that asset to the pledgee.

Rules for competing mortgages, pledges and lien

Where a mortgage, pledge and lien simultaneously exist over a movable asset, the lien will rank ahead of the mortgage and pledge.

Subordination

Under PRC law, contractual subordination may be reached by agreement between all the creditors. In its simplest form, the senior creditors (typically the lenders), the junior creditors (typically the shareholders of the borrower) and the borrower (if required by the creditors) will enter into an inter-creditor agreement or a subordination agreement. This agreement shall stipulate that, unless otherwise permitted by the agreement or with the prior written consent of the senior creditor, all the indebtedness owed to the junior creditors and the right of the junior creditors in respect of that indebtedness shall be subordinated to the indebtedness owed to the senior creditors and to the right of the senior creditor in respect thereof.

Subject to the mandatory statutory principle of the order creditors are paid upon insolvency and the right of revocation conferred to the insolvency administrator under the insolvency law, the contractual subordination shall remain effective in insolvency proceedings. As between the senior creditors and the junior creditors, their subordination arrangements are generally given effect notwithstanding the borrower's insolvency.

5.8 Priming Liens

Under PRC law, if the debtor fails to perform its due debt, the creditor is entitled to retain movable properties of the debtor that have been legally possessed by it and create liens over such movable properties.

In practice, a lender may possess the pledged assets of the pledgor under a pledge provided in favour of the lender. But whether the lender may create liens over such pledged assets in favour of other obligations owed by the same debtor to such lender will be subject to the specific circumstances and the position taken by the PRC courts.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Upon the non-payment by a debtor or events to realise a security interest as agreed by the parties in the security documents, the secured lender may take the following measures to enforce its security interest, without recourse to the PRC court:

- take possession of the collateral agreed upon by the security provider;
- instruct the security provider to sell or directly sell the collateral to a designated third party; or
- instruct the security provider to sell or directly sell the collateral by way of public auction.

If the proceeds obtained from the abovementioned steps exceed the secured indebtedness, the portion that exceeds the secured indebtedness should be attributable to the security provider.

Special Procedure on Enforcement of Security Interest

PRC law provides for a special procedure on the enforcement of security (the "Realisation Procedure"), in which the secured lender may directly apply for enforcement of the security by submission to the court with jurisdiction. Since the Realisation Procedure is a non-litigious proceeding, the court may, at its discretion, only conduct prima facie review of the evidence submitted to prove the existence of secured indebtedness, the creation of a security interest and the occurrence of an event of default, etc.

If there is a substantive dispute between the secured lender and the security provider (regarding the secured indebtedness, or whether any event of default has occurred, etc), the application of the Realisation Procedure will be dismissed and the court will inform the parties to settle their dispute by initiating a litigation procedure.

Restrictions

Lenders may be faced with the following restrictions in the enforcement of a security interest.

Ranking in priority

Besides the limitations set out in **5.7 Rules Governing the Priority of Competing Security Interests**, if the collateral has been mortgaged to other beneficiaries with a prior ranking, the enforcement of security may be subject to the consent of the beneficiaries with a prior ranking, even though the relevant collateral has already been seized by the beneficiary applying for enforcement.

Enforcement of security over construction in progress

The creditor rights of other parties are generally subordinated to payments owed to contractors for construction works.

6.2 Foreign Law and Jurisdiction

Choice of Law

Under PRC law, only contracts connected to foreign-related transactions may choose a foreign law as the governing law, provided that such

choice of law does not contravene the mandatory requirements under PRC laws and does not jeopardise the public interest of the PRC.

Submission to a Foreign Jurisdiction

Generally speaking, the parties are free to submit a dispute related to a foreign-related contract to a foreign court that has an actual connection with the underlying transaction, provided that the PRC court has no exclusive jurisdiction over that dispute. For example, PRC courts shall have exclusive jurisdiction over disputes arising from the performance of a Sino-foreign joint venture, a Sino-foreign co-operative enterprise, a Sino-foreign co-operative exploration or the development of natural resources contracts within the territory of the PRC mainland.

6.3 Foreign Court Judgments

Recognition and Enforcement of Foreign Arbitral Awards

As the PRC is a contracting state to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention"), arbitral awards rendered by arbitral tribunals through institutional arbitration proceedings in another contracting state shall be recognised and enforceable in the PRC, unless they fall within the circumstances set forth under the New York Convention whereby a contracting party may be entitled to refuse to recognise and enforce an arbitration award.

Recognition and Enforcement of Foreign Judgment

In brief, when determining whether a foreign civil judgment will be recognised and enforced, PRC courts rely on the following six standards:

- the relevant foreign judgment must be final and effective;
- pursuant to applicable foreign laws, the court rendering the judgment must have jurisdiction over the case;
- pursuant to applicable foreign laws, the litigation procedure conducted in the foreign court must be fair and legitimate – for instance, the respondent has been duly served and is given the opportunity to be heard, etc;
- conflicting judgments do not exist – PRC courts will not hear any case with identical parties relating to the same subject matter, or in which an effective judgment has not been issued, nor do they recognise a third-country judgment of the same case;
- international treaties or reciprocity exist between the PRC and the other country for the mutual recognition and enforcement of civil and commercial judgments; and
- recognition and enforcement of such judgment do not contravene the fundamental principles of PRC law or sovereignty, security or the public interest.

6.4 A Foreign Lender's Ability to Enforce Its Rights

In general, there is no restriction on the enforcement of a foreign lender's rights under a loan agreement or security agreement, provided that all the registration, filing or other similar formalities as required for cross-border transactions have been duly completed, including but not limited to the following (as applicable).

Foreign Debt Registration

A PRC enterprise is generally required to register its offshore borrowing or offshore debts issue with SAFE no later than three business days prior to utilisation. Any nonfinancial enterprise incorporated in the Greater Bay Area may apply for once-for-all foreign debt quota registration with SAFE to avoid one-by-one registration with

SAFE, subject to meeting relevant requirements from SAFE.

NDRC Registration

According to the Administrative Measures for the Examination and Registration of Medium and Long-term Foreign Debts of Enterprises issued by the NDRC on 5 January 2023, a PRC enterprise is required to conduct registration with the NDRC in respect of offshore borrowing or offshore debts issued by it and any offshore entity or branch controlled by it, and such NDRC registration requirement also applies to the circumstance where a PRC enterprise indirectly borrows offshore debts from overseas, that is, when an enterprise, whose main business activities are conducted within the PRC, issues bonds or borrows commercial loans overseas in the name of an enterprise registered overseas, based on the equity, assets, earnings or other similar rights and interests of enterprises incorporated in the PRC (in each case with a tenor over one year, exclusive of being exactly one year).

Cross-Border Security Registration

A PRC enterprise is required to register with SAFE for its provision of cross-border security and guarantees to secure the indebtedness owed by an offshore borrower to an offshore lender within 15 business days from the date of the relevant security or guarantee agreement. Although failure to complete this registration will not impact the validity of the security and guarantee agreement, the outbound remittance of proceeds obtained through the enforcement of such security or guarantee may be restricted without such registration.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

When the application for insolvency has been accepted by the court, the following may occur in the exercise of the lender's rights:

- automatic acceleration of debt: all the debt of the insolvent company that remains outstanding shall immediately become due and payable; and
- calculation of the interest ceases: upon acceptance of the insolvency application by the court, the calculation of the interest of all the debt shall cease immediately.

If a security provider is involved in a judicial reorganisation procedure, the enforcement of the security interest will be suspended, unless the secured asset is likely to be damaged or its value might be significantly reduced, or there are other circumstances that will jeopardise the creditor's rights.

7.2 Waterfall of Payments

Secured Indebtedness

A secured creditor who has a security interest over a specific asset of the insolvent company shall have priority over the collateral. However, if the proceeds obtained from the enforcement of security are insufficient to discharge all the secured indebtedness, the remaining unsettled liabilities should be treated as unsecured indebtedness.

Unsecured Indebtedness

After the discharge of all the insolvency costs and expenses and the collective debts, the remaining insolvency proceeds shall be applied in the following order:

- payments to employees, including wages and compensation owed;
- other social insurance expenses and unpaid taxes; and
- unsecured indebtedness owed to normal creditors.

Where the insolvency proceeds are insufficient to discharge all the liabilities in the same order, the payment shall be made on a pro rata basis.

7.3 Length of Insolvency Process and Recoveries

How long it takes to complete a company's insolvency process depends on various factors such as the company's debt situation, the complexity of the relationship between creditors and the company, and to what extent the creditors and the company could co-operate. In practice, it may take several months to several years to complete the insolvency process.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Under PRC law, if an enterprise is unable to repay its due debts, and its assets are insufficient to repay all its debts, or it is clearly insolvent, or it is highly likely that it will become insolvent, the enterprise may enter reorganisation in accordance with the relevant laws. Both the enterprise and the creditors may directly apply to the PRC court for the enterprise's reorganisation.

If the PRC court determines that, upon its examination, the application for reorganisation complies with the relevant legal provisions, it will rule on the enterprise's entry into reorganisation and make an announcement. The reorganisation procedures generally include the following steps:

- convening the creditors meeting;
- submission of the draft reorganisation plan by the enterprise or the administrator to the PRC court and the creditors meeting;
- approval of the reorganisation plan;
- implementation and supervision of the reorganisation by the administrator; and
- submission of a supervision report to the PRC court upon completion of the reorganisation.

7.5 Risk Areas for Lenders

Restriction on Separate Settlement

The insolvency administrator is entitled to apply to the court for revocation of a separate settlement made by the insolvency company with the creditor within six months prior to the date of the court accepting the insolvency application, unless such separate settlement is made to benefit the assets of the insolvency company.

Revocation by the Insolvency Administrator

If the insolvent company does any of the following within one year prior to the date the court accepts the insolvency application, the insolvency administrator may apply to the court for revocation:

- transfers its assets without any consideration;
- sells its assets at an obviously unreasonable price;
- provides security for an unsecured indebtedness;
- makes early redemption on undue liabilities; or
- waives any debts owing to it.

8. Project Finance

8.1 Recent Project Finance Activity

Project finance was introduced to the PRC in the 1980s and has been developing rapidly following the economic reform and opening up of

the infrastructure construction sector since the 1990s.

The public-private partnership (PPP) model is currently the most popular model in the project finance market in the PRC. Based on the data disclosed in the National PPP Information Platform, as of 31 December 2022 there were 14,038 PPP projects in the database nationwide, with a total investment of RMB16.62 trillion, covering 19 sectors, including energy, transportation, water resources, affordable housing, tourism, medical care and public health, education and government infrastructure.

8.2 Public-Private Partnership Transactions

Modes of PPP Transactions

There are four modes of PPP in the PRC:

- BOT (build–operate–transfer);
- BOOT (build–own-operate–transfer);
- BTO (build–transfer–operate); and
- BOO (build–own-operate).

BOT has long been the most widely adopted mode. These modes will be used according to the repayment sources of projects, as follows:

- BOT or BOOT for projects that have a steady project revenue to cover all the investment costs and expenses;
- BOT or BOO for projects that lack sufficient project revenue and rely on government subsidy; and
- BOO is recommended by the NDRC for non-profit projects, accommodated with procurement by the government.

BTO is often seen in public utilities projects.

Supervising Administration and Restrictions

The PPP mode mainly applies to public service and infrastructure projects that are suitable for market-driven operation, such as electricity, water supply and public transportation, in which the franchisee will be selected through a formal tender process or competitive negotiations. The NDRC recommends that the PPP mode should be the first choice for the construction of new municipal engineering and urbanisation pilot projects.

In the PRC, PPP transactions are under the supervision of the NDRC, the Ministry of Finance and other regulatory authorities based on the nature of each project, including the Ministry of Housing and Urban-Rural Development, the Ministry of Transport, the Ministry of Water Resources and the PBOC.

To implement the general principle of balance between risks and returns in supervising PPP transactions, the PRC government and any governmental authorities are prohibited from repurchasing the share capital of private entities, indemnifying any loss suffered by private entities, or giving any kind of undertaking on a fixed return. A PPP transaction may also be subject to further limitations due to its location and industry.

8.3 Governing Law

As set out in **6.2 Foreign Law and Jurisdiction**, under PRC law, only contracts connected to foreign-related transactions may choose a foreign law as the governing law, provided that such choice of law does not contravene the mandatory requirements under PRC laws and does not jeopardise the public interest of the PRC.

Also, the parties are generally free to submit a dispute related to a foreign-related contract to

a foreign court that has an actual connection with the underlying transaction, provided that the PRC court has no exclusive jurisdiction over that dispute. Under PRC law, disputes arising from construction contracts shall be subject to the exclusive jurisdiction of the PRC court in the place where the relevant real property is located, unless the parties choose to submit such disputes to arbitration in the relevant agreement.

8.4 Foreign Ownership

Under PRC law, land is owned by the state or peasant collective, and no entity or individual is allowed to occupy, trade, or illegally transfer land in any other manner. However, the right to use land can be transferred in accordance with relevant laws, and foreign companies, other organisations and individuals, unless otherwise prohibited by laws, may obtain land use rights upon satisfaction of the relevant requirements stipulated by law.

Water resources are also owned by the state in the PRC, and relevant entities shall apply to the water administrative department or river basin management authority for a water use permit and pay corresponding fees to obtain the right to use water.

8.5 Structuring Deals

The first issue a foreign investor should consider when structuring a project is whether the business sector of the project has any foreign investment restrictions. Foreign investment control in the PRC adopts a "Negative List" mechanism, whereby the NDRC and the Ministry of Commerce will issue and update a list of industrial sectors and business types that are prohibited to foreign investors or that restrict foreign control. According to the latest Negative List promulgated by the NDRC and the Ministry of Commerce in 2021, such prohibited sectors include the prospecting and mining of rare earth, radioactive minerals and tungsten, etc. Some areas restrict foreign control – for example, nuclear plants must be controlled by domestic investors.

Foreign investors should also consider the bankability of the project and the related contractual arrangements. Domestic banks are usually more willing to rely on the credit of sponsors instead of only on the project assets and revenues. When assessing the bankability of the project, the investors should therefore conduct a thorough and comprehensive risk analysis to properly allocate the risks in the transaction documents.

8.6 Common Financing Sources and Typical Structures

The most traditional financing sources of project finance transactions are term loan facilities provided by a single institution or a consortium of policy banks, commercial banks or other financial institutions. In the past few years, participants in the project financing market have become more diversified, with social security funds, insurance funds and other public funds being permitted to be involved in project financing through debt, equity investment or otherwise. Meanwhile, the project owners of large-scale infrastructure projects are considering using more sophisticated structured financing instruments such as project revenue bonds, Green Bonds, Green ABS and REITs as alternative financing sources.

In general, financing on all types of projects will be subject to meeting debt-to-equity ratio requirements (no higher than 80:20), which may be adjusted from time to time by the PRC government according to the market situation.

8.7 Natural Resources

Ownership and Acquisition of Natural Resources

Natural resources within the territory of the PRC are owned exclusively by the state, including minerals, oil and gas. Relevant permits and licences are required for exploiting, acquiring and using such natural resources.

Export of Natural Resources

Under PRC law, export control is administered through a dual mechanism: quota administration and export licensing. Certain goods are subject to quantity-based restrictions. These goods can only be exported up to specified quota limits. Other goods subject to export restrictions require an export licence. The goods subject to export restrictions are regulated under the list of goods subject to a quota and the list of goods that require an export licence, which are published by the Ministry of Commerce on an annual basis.

According to such lists, natural resources including coal, oil and various rare minerals cannot be exported without complying with relevant requirements.

8.8 Environmental, Health and Safety Laws

Responsible Regulatory Bodies

The Ministry of Ecology and Environment (MEE) is responsible for reviewing and approving the environmental impact assessment reports of projects, monitoring project companies' compliance with environmental protection laws and policies, and supervising the installation and acceptance of necessary waste prevention and treatment facilities within construction projects.

The National Health Commission and the Ministry of Emergency Management are the regulatory authorities overseeing health and safety issues in the PRC.

Applicable Laws and Regulations

The main environmental laws applicable to projects in the PRC are the Environment Protection Law, the Environmental Impact Assessment Law and the Fire Protection Law. Depending on its nature, a project in the PRC may also be subject to legislation on air pollution, sustainable development, waste management, water protection, soil protection, noise pollution, etc.

As for health and safety issues, the Law on Prevention of Occupational Diseases and related implementing rules and guidelines serve an important role in regulating employers' obligation to ensure the health and safety of employees. Based on the nature of a project, certain sector-specific laws and regulations may also apply.

Trends and Developments

Contributed by:
Stanley Zhou, Zhou Jie, Yu Leimin and David Mu
King & Wood Mallesons

King & Wood Mallesons has an award-winning and independently recognised banking and finance legal team, which is active in finding innovative finance solutions for the market's most complex and sophisticated transactions. The team of almost 30 partners and more than 130 associates is at the forefront of this highly evolving market, handling banking and finance transactions across Greater China and providing clients with the latest industry insights and know-how. It offers comprehensive legal services across the full spectrum of financial products, including aircraft/vessel and other asset financing/leasing, project financing, M&A financing, trade finance, real estate financing, pre-IPO and privatisation financing, syndicated loans, debt capital markets, asset-backed securitisation and structured finance, non-performing asset sale and purchase, debt restructuring (out of court), derivatives, fintech, bank card clearing and third-party payment.

Authors

Stanley Zhou is a partner at King & Wood Mallesons. He specialises in general banking, structured financing, real property financing, acquisition financing, financial regulation and compliance, financial institutions and fintech. He is experienced in acting as a leading counsel in advising on large, complex cross-border transactions and is recognised for his excellent deal-management skills. Stanley has extensive experience in banking and finance and provides legal advice to domestic and international banks and other financial institutions on a variety of matters and also advises borrowers and other corporate clients in receipt of various financial services from banks and other financial institutions.

Zhou Jie is a partner at King & Wood Mallesons. He specialises in banking, finance and investment. He has extensive experience in traditional and innovative financing businesses, including asset finance and leasing, real estate investment and financing, mergers and acquisitions, leveraged finance, structured finance and the establishment and merger of financial institutions. Zhou Jie has acted for domestic and foreign investment banks, commercial banks, leasing companies, asset managers, fund managers and multinational corporations, providing legal services for foreign clients' investment transactions and operations in China, as well as domestic clients' investment and financing activities in overseas markets.

Yu Leimin is a partner at King & Wood Mallesons. He specialises in general banking, cross-border financing, fintech, financial regulation and compliance as well as internet information services. He has extensive experience in financial regulation and compliance and provides the full range of legal and compliance services to financial infrastructure institutions, domestic and international banks and other financial institutions. He has strong expertise in fintech and advises many leading internet companies on a wide range of matters, including set-up, merger and acquisition of financial institutions, cybersecurity and data compliance, cross-border internet payments and the business applications of blockchain.

David Mu is a partner at King & Wood Mallesons. He specialises in cross-border structured products/transactions, exchange-traded or OTC derivatives, financial infrastructure, banking service documentation and GBA-focused financial projects. He is experienced in a wide range of investment products/transactions, including ISDA-, NAFMII- or MiniMaster-based OTC trades, GMRA-based repo trades, structured transactions based on the (R)QDII regime, (R) QFII documentation, precious metal transactions, central clearing and regulatory advises on international regulatory reforms, various cross-border programmes accessing onshore futures market, CIBM and exchange-traded markets and complex cross-border projects relating to NPLs, green finance and factoring assets. David has advised numerous international clients on cross-border marketing and GBA initiatives.

King & Wood Mallesons

18th Floor, East Tower
World Financial Center
No.1 Dongsanhuan Zhonglu
Chaoyang District,
Beijing 100020
P. R. China

Tel: +86 10 5878 5588
Fax: +86 10 5878 5566
Email: markets@cn.kwm.com
Web: www.kwm.com/zh/cn

金杜律师事务所
KING&WOOD
MALLESONS

Financial Regulatory Reform Clarifies the Boundaries of FinTech

In 2023, in conjunction with the institutional reform by the State Council, China's financial regulatory structure was adjusted to a "one bank, one bureau, one commission" framework (People's Bank of China (PBOC), National Administration of Financial Regulation, and China Securities Regulatory Commission (CSRC)). The reformed financial regulatory framework adopted the concepts of behavioural regulation and functional regulation, placing greater emphasis on protecting the rights of financial consumers, strengthening financial risk management, together with prevention and disposal measures.

On 30 June 2023, the grace period for internet lending business and disconnecting of bank-platform credit information transmission expired. As a result, for internet lending businesses, financial institutions need to fulfil their loan management responsibilities by comprehensively managing loan risks, information data and loan funds, and enhancing the quality and effectiveness of financial services. For credit reporting, credit information can only be collected by licensed credit reporting agencies and used to assess specific individuals' credit situations. The phrase "bringing all types of financial activities under regulation legally" means that different financial institutions engaging in the same type of financial activity will be subject to the same regulatory standards, making the boundary between financial activities and internet platform activities clearer and reducing the occurrence of "regulatory arbitrage".

In July 2023, Chinese financial regulatory authorities imposed significant fines on numerous financial institutions, payment providers and giant internet platforms. This has marked the completion of rectifying most prominent issues in platform enterprises' financial operations. Large platform enterprises that have concluded their concentrated rectification efforts will henceforth be subject to ongoing, regularised supervision. With compliant and sound operations, platform enterprises and financial technology businesses should better serve the real economy and the needs of people's livelihoods.

Active Cross-Border Payments Support Chinese Enterprises Going Global

In recent years, cross-border transactions have undergone notable changes. On one hand, there has been rapid growth in individual consumer demands such as cross-border e-commerce and cross-border tourism. These cross-border transactions are characterised by smaller transaction amounts but high frequency. On the other hand, new business formats such as market procurement trade and overseas warehouses have been emerging. With the trend of independent platforms and Chinese brands going global, export merchants have put forward higher requirements for settlement rates and flexibility. Therefore, third-party cross-border payment providers, centered around payment institutions, have developed rapidly, offering fast settlement speeds, low fees, value-added services like exchange rate locking and advance payments, which effectively meet market demands.

To encourage cross-border RMB settlement and mitigate exchange rate risks for Chinese enterprises, the PBOC officially released the Regulatory Guidelines on Cross-Border RMB Settlement for New Forms of Foreign Trade («关于支持外贸新业态跨境人民币结算的通知») (Notice [2022] No 139). The new rules expand the scope of cross-border RMB payment transactions to include operators of new forms of foreign trade, and payment insti-

tutions can extend their services from goods and service trades to current accounts.

In practice, to achieve full-loop closure of merchants and funds, well-established institutions with overseas payment qualifications are actively seeking to take stakes in or control of domestic payment institutions. This has led to a convergence of the business co-operation between domestic and overseas payment institutions, highlighting the continued importance of domestic payment licenses in cross-border payments. Additionally, leading cross-border payment institutions have initiated overseas listing plans to pursue broader development. As the legislation process accelerates for the Non-Bank Payment Institution Regulations («非银行支付机构条例»), regulatory rules for the payment industry will be reshaped. Within the new regulatory framework, cross-border payments are expected to continue to grow rapidly, aiding more Chinese enterprises in expanding their global businesses.

Strengthening Financial Consumer Protection, Personal Information Protection, and Data Compliance

The Administrative Measures for Consumer Rights Protection of Banking and Insurance Institutions («银行保险机构消费者权益保护管理办法») officially came into effect at the end of 2022. The protection of financial consumer rights is expected to remain the focus of financial regulation in 2023. Under the concepts of "financial services for the people" and "responsible finance", regulatory requirements for financial consumer protection will become more detailed, encompassing information disclosure, marketing and promotion, personal information protection, and complaints handling. According to the State Council's financial regulatory reform, functions previously scattered among the "one bank and two commissions" will be integrated into the National Administration of Financial Regulation, so as to unify supervision and enhance efficiency.

In July 2023, the PBOC issued the Measures for Data Security Management in the Field of People's Bank of China Operations (Draft for Comments) («中国人民银行业务领域数据安全管理办法(征求意见稿)»). This signifies the official initiation of important data identification as well as the data classification and grading within the financial industry. Going forward, data controllers will need to classify and grade data processed in their operations according to a three-level-and-five-tier standard, and implement corresponding data protection measures based on the results of the classification and grading. The new rules also recognise the value of emerging technologies, such as privacy computation, which will contribute to promoting data circulation where risks are manageable.

Overall, the regulatory scope of financial technology will become broader, transitioning from traditional business regulation to dual regulation of business and data. Additionally, the granularity of financial technology regulation will become more refined.

Launch of Swap Connect (Northbound)

The debut launch of Northbound Trading under "Swap Connect" took place on 15 May 2023. This is the youngest programme in the cross-border "Connect" family and was initiated by a joint announcement issued by the PBOC, the Securities and Futures Commission of Hong Kong (SFC) and the Hong Kong Monetary Authority (HKMA) back on 4 July 2022.

Swap Connect has been designed as an arrangement that allows investors to participate in the interest rate swap markets in Mainland China and

Hong Kong through an interconnection between their respective financial market infrastructures, namely the China Foreign Exchange Trade System (CFETS) and the Interbank Market Clearing House Co., Ltd. (also known as the Shanghai Clearing House, or SHCH), as the financial market infrastructures in Mainland China, and OTC Clearing Hong Kong Limited ("OTC Clear"), as the financial market infrastructure in Hong Kong.

There are currently three inbound channels for foreign investors to access the China Interbank Bond Market, being: (i) Northbound Bond Connect; (ii) the China Interbank Bond Market Direct Access Scheme; and (iii) the (RMB) Qualified Foreign Institutional Investor scheme.

In recent years, there have been a series of measures aimed at further opening up the China Interbank Bond Market to foreign investors. As foreign investors' holdings of RMB-denominated bonds increase and more trading takes place, their demand for cost-effective interest rate risk management tools continues to grow. Today, RMB interest rate swaps are amongst the most popular and actively traded products in the China interbank derivatives market. SHCH has been providing central clearing services in respect of RMB interest rate swaps, effectively mitigating bilateral counterparty and systemic risks. In 2016, the PBOC issued an announcement encouraging more foreign institutional investors to enter into interest rate swaps for hedging purposes. It is understood that CFETS has, since early 2020, allowed foreign institutions to enter into derivatives transactions via the CFETS trading system. To this end, CFETS has agreed to onboard foreign institutions that have filed either an executed ISDA Master Agreement or an executed NAFMII Master Agreement with CFETS.

Against this backdrop, Swap Connect will further facilitate foreign investors' participation in interest rate swaps and other derivatives transactions in the China interbank market to hedge interest rate risk and other risks associated with their onshore financial investments.

Similar to Bond Connect, Swap Connect comprises both a "Northbound" leg and a "Southbound" leg. Northbound Swap Connect (which was launched on 15 May 2023) allows foreign investors to participate in China's interbank derivatives market through an interconnection arrangement between the financial market infrastructures of Hong Kong and Mainland China relating to trading, clearing and settlement. Southbound Swap Connect is expected to be launched in due course, which will then allow Chinese onshore investors to access the Hong Kong derivatives market through the financial market infrastructure interconnection arrangement.

With regard to the conclusion and execution of derivatives transactions under Northbound Swap Connect, CFETS has established a trading link with offshore electronic trading platforms (such as Bloomberg and Tradeweb) ("Swap Connect Trading Link") so that foreign investors do not have to file with CFETS or open onshore accounts. Instead, they can place orders directly with the relevant offshore trading platforms without having to change their usual trading practices. As for the clearing of derivatives transactions concluded via the Swap Connect Trading Link, SHCH and OTC Clear have established a clearing link and each will act as a central counterparty in respect of such transactions ("Swap Connect Clearing Link").

One of the most important changes reflected in the final Swap Connect rules is that onshore

and offshore Swap Connect participants are no longer mandatorily required to enter into a derivatives master agreement, although they may enter into one if they so choose. A Q&A published by the PBOC helpfully clarifies that derivatives master agreements recognised by the PBOC not only include the Chinese language NAFMII Master Agreements that are primarily used in the onshore derivatives market but also include the ISDA Master Agreements and the FIA-ISDA Cleared Derivatives Execution Agreement (CDEA) that are widely used in the international derivatives markets. It is reported that the National Association of Financial Market Institutional Investors (NAFMII) is also prepared to publish a special cleared derivative agreement in order to document the market participants' mutual intention to submit the trades for clearing and to cancel the trades in the event of a clearing failure.

Use of RMB Collateral in International Transactions

In light of the growth of China's economy, the internationalisation of the RMB and the further opening of China's domestic financial market to overseas investors, some international firms are exploring the potential of posting Chinese Government Bonds (CGB) as collateral for various purposes in the international markets (including the use of CGB as underlying securities in international repo trades and the use of CGB in order to satisfy the initial margin (IM) regulations in international derivative trades).

Since 2015, overseas RMB clearing banks, overseas RMB participating banks, foreign central banks, foreign monetary authorities, international financial organisations and sovereign wealth funds have been allowed to trade and settle bond repos in the CIBM. However, due to a number of regulatory and policy considerations (eg, the issue of whether funds under repo transactions are allowed to be remitted out of the PRC is still hotly debated), the CIBM bond repo transactions have not been opened to the majority of the foreign players, comprising (RMB) qualified foreign institutional investors (QFI), overseas institutional investors of the CIBM Direct programme ("CIBM Direct Participants") or foreign investors of the Bond Connect programme.

While there has been a growing demand for more overseas institutional investors to enter into repurchase agreements with CGBs and other CIBM bonds as collateral, overseas investors are also considering many other factors, as outlined below.

- It is unclear whether the parties should document their CGB repos by the international industry-standard master agreement – GMRA – governed primarily by English law or the onshore industry documentation which is called NAFMII Master Repo Agreement ("NAFMII MRA"), published by NAFMII since 2013. Those two types of industry master agreements are different in substance.
- Unlike GMRA-documented repos that are based on outright transfer, the majority of onshore repos under the NAFMII MRA are based on security interest created over CIBM bonds. Onshore financial market infrastructures such as China Central Depository & Clearing Co., Ltd. (CCDC) and SHCH may need to undergo significant operational and system upgrades in order to support the increasing volume of transfer-style repo trades to come on a cross-border basis.

Likewise, market participants in the derivatives market continue to look for high-quality liquid assets (HQLA) as eligible initial margin and RMB bonds (including CGBs) appear to be very

attractive in this regard. CCDC, SHCH and some other international custodian banks are keen to introduce a new programme and documentation (such as collateral transfer agreements, PRC-law security agreements, collateral management service agreements, account control agreements, etc) for pledge arrangements of CGB as initial margin in relation to international uncleared derivatives transactions. Apart from the creation and perfection of security interest over CGB IM under PRC law, it is also critical to ensure that the CGB IM is enforced in a timely manner upon the default of the IM provider and that the liquidation proceeds are repatriated smoothly out of China, if needed.

Draft FSL Introducing International Standards and Resolution Tools

The PBOC published the Financial Stability Law of the People's Republic of China (Consultation Draft) («中华人民共和国金融稳定法 (草案征求意见稿)») (the "PBOC FSL Consultation Draft") and the relevant drafting notes on 6 April 2022. Subsequently, the Standing Committee of the NPC published the Draft Financial Stability Law of the People's Republic of China ("Draft FSL") («中华人民共和国金融稳定法 (草案)») on 30 December 2022.

The Draft FSL sets out a number of high-level principles relating to areas such as crisis prevention, risk mitigation and recovery, and the takeover or resolution of PRC entities in the financial sector, including but not limited to PRC financial institutions. In particular, the Draft FSL, when passed, will further enhance the legislative framework for the recovery and orderly resolution of PRC financial institutions by, among other things, introducing a range of resolution tools that are broadly analogous to those set out in the Key Attributes of Effective Resolution Regimes ("Key Attributes") published by the Financial Stability Board, which include empowering the resolution authority to impose a temporary stay (subject to 48 hours) of termination rights in respect of qualified financial transactions.

CROATIA

Law and Practice

Contributed by:
Željka Rostaš Blažeković, Margita Kiš Kapetanović,
Zvonimir Kalember Skoko and Franka Vuletić
Porobija & Porobija

Contents

Porobija & Porobija is based in Zagreb. Its banking and finance team consists of two partners, two attorneys at law and two associates, who offer their expertise in project and asset finance, securities offerings, syndicated loans, contract law, real estate law and projects involving commercial/company law. The team acts for arranging banks, lenders and borrowers in virtually every type of commercial and financial transaction, and advises clients from various industries.

Authors

Željka Rostaš Blažeković is a partner at Porobija & Porobija. Her key practice areas are banking and finance, energy and infrastructure, and capital markets. She has been engaged in a number of capital investment projects, as well as in major Croatian infrastructure development projects, mostly on behalf of international clients. Željka has advised lenders and borrowers on a number of major transactions in the country.

Margita Kiš Kapetanović is a partner at Porobija & Porobija and has in-depth experience in providing Croatian legal advice on real estate, construction and project development matters, and in complex civil court proceedings. She advises and represents Croatian and foreign investors in the Croatian legal aspects of project development, real estate law, employment law and the law of contracts. Margita has worked on real estate/construction segments of numerous projects and is currently leading the dispute team representing the leading Croatian bank in a substantial number of individual litigation cases arising from the first collective lawsuit for the protection of consumers' rights in Croatia, related to variable interest rates and/or currency clauses in consumer loans.

Zvonimir Kalember Skoko is an attorney at law at Porobija & Porobija and a member of the firm's legal counselling team. He has experience in legal fields such as banking and finance, litigation, insolvency and labour law. Zvonimir has participated in various projects and financing transactions in Croatia, with a primary focus on security arrangements.

Franka Vuletić is a junior attorney at law at Porobija & Porobija and a member of the firm's legal counselling team. She has experience in the legal fields of finance, litigation, labour law and real estate law.

Porobija & Porobija

Galleria Importanne
Iblerov trg 10/VII, p.p. 7
HR-10000
Zagreb
Croatia

Tel: +385 1 4693 999
Fax: +385 1 4693 900
Email: porobija@porobija.hr
Web: www.porobija.hr

Porobija & Porobija

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

The Croatian National Bank (CNB) has reported that its monetary policy was primarily focused on preparing for the introduction of the euro, which significantly reduced the effects of external shocks on the domestic financial market. As a result, the adjustment of monetary policy instruments led to historically high levels of liquidity in the banking system, effectively lessening the transmission of tighter funding conditions prompted by the ECB's monetary policy. Despite experiencing a gradual rise in loan interest rates and stricter standards, banks demonstrated remarkably strong lending activity in 2022, leading to a significant acceleration in credit growth on an annual basis.

Furthermore, the CNB has reported that interest rates on loans to non-financial corporations experienced a more significant increase compared to loans to households. Interest rates on first-time loans to households remained around 4%, corresponding to the average level in 2021. On the other hand, in December 2022, interest rates on first-time loans to corporations reached 3.2%, reaching the highest level since 2017.

The average interest rates on housing loans were around 2.5%, while the interest rates on non-purpose cash loans were around 5.4%. A comparable trend was seen in passive interest rates, as interest rates on corporate deposits increased from about 0% in 2021 to roughly 0.9% by December 2022, while interest rates on household deposits remained almost steady during this period.

1.2 Impact of the Ukraine War

It has been reported by the CNB that throughout 2022, the world's financial markets experienced heightened geopolitical uncertainties due to the ongoing conflict in Ukraine, coupled with a gradual tightening of monetary policies by central banks worldwide in response to soaring inflation rates. Volatility on financial markets has risen, accompanied by a decline in the values of major stock and bond indices, as well as an increase in borrowing costs.

The normalisation of the ECB's monetary policy in 2022 had a restricted impact on financing conditions in Croatia, with noticeable increases in the borrowing costs for the government and non-financial companies. The values of the stock and bond indices on the Zagreb Stock Exchange decreased, while the foreign exchange market stabilised, reflecting the certainty of the introduction of the euro as the official currency. During this period, the assessed stress on the domestic financial markets remained at relatively low levels. During 2022 the performance of non-financial companies rebounded, while the number of businesses in Croatia experienced the highest growth in the past five years, despite an increased number of company exits from the market. Simultaneously, the rise in prices of raw materials, particularly energy resources, driven by strong demand, prompted heightened borrowing within the business sector to finance operational needs, especially within the energy sector. With the gradual increase in variable interest rates for loans, the burden of debt repayment for the corporate sector slightly rose, yet it remained at a low level, considering the relatively high proportion of fixed-rate loans.

The increase in interest rates on loans with variable interest rates stands out as a risk to the ability of households to service debt. An additional

contribution to this risk arises from rising living costs that concurrently erode savings, thereby reducing households' resilience to potential adverse economic shocks. This could particularly impact the most vulnerable households' segment, which already allocate a relatively high portion of their income to living expenses and loan repayments.

Strong domestic demand, supported by, inter alia, government subsidy programmes, alongside foreign citizens' demand in coastal parts of Croatia, within the context of limited property supply and increasing construction costs, have influenced the acceleration of the housing price growth.

1.3 The High-Yield Market

The high-yield market remains relatively modest, as the credit institutions retain their dominant position in the financing market in Croatia.

1.4 Alternative Credit Providers

At the end of October 2021, the value of projects contracted through European Structural and Investment Funds (ESI Funds) was EUR13.19 billion – ie, 122.88% of the allocated funds for the financial period 2014–2020. Furthermore, a Cohesion Policy has been introduced in the EU for the financial period 2021–2027, under which numerous EU Funds have been established with a purpose of financing various projects within said period. Funds allocated to the Republic of Croatia for the financial period 2021–2027 in current prices amount to more than EUR14 billion from the EU's Multiannual Financial Framework and slightly more than EUR11 billion from the NextGenerationEU economic recovery package.

Furthermore, during a plenary session held on 23 November 2020, the Members of the European Parliament approved assistance to Croatia from the European Solidarity Fund for the mitigating of the consequences of the devastating earthquake that struck Zagreb on 22 March 2020 in the amount of EUR683.7 million. On 7 July 2022, the government of the Republic of Croatia adopted an amendment to the decision on the distribution method of non-repayable financial resources from the European Union Solidarity Fund (EUSF), approved for financing earthquake damage repair. As a result, by 9 June 2023, all funds from EUSF for earthquake consequence mitigation had been utilised.

The portion of financing through crowdfunding still remains minor, although it has played a more significant role in the last two to three years. Most of the biggest crowdfunding platforms have gone from the region, with only the smaller or local ones remaining active.

The Zagreb Stock Exchange Progress Market was registered at the beginning of 2019 and is a multilateral trading facility that may be used by SMEs in order to achieve the implementation of their investment plans. The year 2022 brought only two listings of shares on the Progress Market and six listings resulting from recapitalisation as well as the listing of five bonds. A special novelty on the market was the listing of the first "green" bond.

1.5 Banking and Finance Techniques

To a great extent, Croatian corporate borrowers rely on financing by local banks and their parent banks, and in the case of financing of larger projects, financing by bank syndicates that often include one or two local banks in addition to the international banks. In the past few years, it has become more common for local banks to also act as security agents. Financing transactions that include international banks is usually based on complex loan documentation governed by

foreign law (usually English law) that comply with the Loan Market Association standards, while the loans granted by local banks are usually subject to much simpler documentation governed by Croatian law and such transactions are very often handled by the local banks in-house.

1.6 ESG/Sustainability-Linked Lending

Supporting the goals of the European Union, the Republic of Croatia stipulates in its National Development Strategy that in the next ten years it will direct national and European funding towards the following:

- promoting a sustainable economy and society;
- recovering from and strengthening resilience to crises;
- green and digital transitions; and
- balanced regional development.

The financial industry has a key role in achieving these goals at the local and global level, in directing capital flows towards sustainable investments – ie, investments that support the goals of sustainable development.

However, in practice, there have been challenges in determining which investments can be considered investments in sustainable development and to what extent, as well as challenges in preventing investment in entities that use manipulative green marketing (so-called greenwashing). The main problem for the financial industry is the harmonisation of various ESG reporting standards, definitions and processes developed by numerous participants in the financial markets and rating agencies.

In March 2021 the Croatian Financial Services Supervisory Agency (Hanfa) published guidelines for the preparation and announcement of ESG relevant information for issuers, with the aim of enabling the uniform treatment of all issuers on the Croatian market so that the stated information is comparable, reliable and understandable.

The guidelines indicate how to meet the obligations under the Taxonomy Regulation in the transitional period and the extent of ESG indicators that issuers can report to ensure the necessary transparency towards financial market participants, financial advisers who are required to apply the Sustainable Finance Disclosure Regulation, ESG rating agencies, suppliers and others.

2. Authorisation

2.1 Providing Financing to a Company

Pursuant to the Croatian Credit Institutions Act, banks and financial institutions must do the following in order to be authorised to provide financing in the territory of Croatia:

- obtain a licence to provide financial services (for a Croatian-based credit institution or a Croatian branch of a credit or financial institution based in the EU, European Economic Area (EEA) or a third country) and register with the court; or
- directly render mutually recognised financial services (in the case of an EU or EEA-based credit and financial institution) on the basis of a "passport" notification to the CNB, provided such services are not rendered on a regular, frequent or ongoing basis.

In addition, under Croatian law and pursuant to the views of the CNB, if a lender's activities are not effectively carried out in the territory of Croatia (but rather on a cross-border basis or on the

basis of consumption abroad), the lender (either a bank or financial institution) should be able to provide financing to a Croatian entity, but would then need to make sure that:

- the loan agreement is not executed in Croatia;
- the offer to finance a Croatian borrower is not made in Croatia (including via the international lender's representative, agent or similar); and
- the offer to finance a Croatian borrower is given on a reverse inquiry basis.

In Croatia, financing can also be granted by other legal and natural persons without any special licence, provided that such activity is not considered to be the business activity of the relevant entity.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

In principle, foreign lenders are not restricted in granting loans, provided that the lending activities are pursued in a manner as described under **2.1 Providing Financing to a Company** and, particularly in relation to cross-border lending, that, inter alia, a loan agreement is either executed by both parties outside Croatia or is at least executed by distant means of communication, without the lender's personnel, agent or similar being present in Croatia, and (pursuant to the views of the CNB) that the financing is based on reverse solicitation by the borrower.

Taking into account the recent ECJ decision and considering that the Constitutional Court of the Republic of Croatia has repealed the Act on Nullity of Loans with an International Element Concluded in the Republic of Croatia by its decision dated 3 November 2020, lending by EU lenders should not be considered problematic. However, lenders should be aware that consumer loan debtors are still protected by the Consumer Credit Act in proceedings on the nullity of loan agreements involving unauthorised creditors and/or unauthorised credit agents.

3.2 Restrictions on Foreign Lenders Receiving Security

There are no particular restrictions or impediments on granting security or guarantees to foreign lenders, noting however that a foreign lender needs to obtain a personal identification number (OIB) in order to be registered as a holder of any security interest in any Croatian register. Please see **3.3 Restrictions and Controls on Foreign Currency Exchange**.

3.3 Restrictions and Controls on Foreign Currency Exchange

Pursuant to the Foreign Exchange Act, when a resident grants a loan or issues a guarantee for the benefit of a non-resident, it must obtain some form of adequate security or collateral in return, in order to secure repayment. Failure to do so represents a misdemeanour, and the respective resident may be fined.

Croatia joined the euro area on 1 January 2023 and the fixed conversion rate was HRK7.53450 for EUR1. The introduction of the euro has eliminated foreign exchange risk and the costs of exchange rate fluctuations in euro transactions with Croatian entities.

The transfer abroad by a non-resident of a profit arising from direct investment is free, under the condition that the applicable profit tax is paid in the Republic of Croatia.

3.4 Restrictions on the Borrower's Use of Proceeds

A borrower's use of proceeds from loans and debt securities should be in line with the conditions set out in the respective loan agreement or prospectus. The effects of a failure to comply depend on the contractual arrangements and/or the generally applicable rules on obligations. The failure of an issuer of debt securities to use the respective proceeds in line with the purpose specified in the prospectus may lead to the liability of an issuer and some other persons for damage caused to the investor by the fact that the information that is relevant to the valuation of the debt securities is incorrect or incomplete, if such incorrect or incomplete information in the prospectus is their fault. The issuer and its responsible persons may also be fined if the prospectus does not contain the correct and complete information prescribed by the applicable laws and regulations.

3.5 Agent and Trust Concepts

The concepts of agent and trust are generally not recognised in Croatian law, as the holder of a security interest simultaneously has to be a creditor of the respective secured claim.

In cases where more creditors are envisaged, a secured party is usually a security trustee or a security agent holding the respective security; however, given that under Croatian law (as the governing law for the security interests to be registered in Croatian registries) the security interest is an accessory to the claim it secures and thus has to remain with the creditor and cannot be held by an agent/trustee, for years now this has been resolved in relevant transactions by way of a so-called parallel debt or joint creditor relationship, governed by English law (or another applicable law that recognises such concept), which are concepts that are also used in various other European jurisdictions to deal with the same issues.

3.6 Loan Transfer Mechanisms

Pursuant to the Croatian Code of Obligations, any receivable is assignable, unless the assignment of such receivable is proscribed by law or the receivable is strictly personal or, by its nature, controversial to the assignment. Furthermore, the assignment contract will have no effect towards the obligor (ie, the borrower) if the underlying contract between the lender and the borrower prohibits the transferability of the receivables.

After the execution of the assignment agreement, the borrower should, in principle, be notified by the original or new lender of the assignment and the fact that the new lender is now the creditor of the receivables, although this is not a precondition for the effectiveness of the assignment. In the case of assignment, together with the claim being transferred, accessory rights are automatically transferred to the new lender (security instruments, rights to interest, etc), noting, however, that the transfer of the respective security interests registered in various registries should be registered therein and that the formal (and notarised) consent of the transferring lender is required.

It should be noted that the assignee should have the same legal position towards the debtor as was previously held by the assignor.

If there is a need to transfer the whole contractual relationship between the original lender and the borrower to the new lender, the loan agreement must be transferred, and the borrower needs to consent to such transfer, noting that such consent may already be given in advance in the relevant loan agreement (in which case

only notification to the borrower is required for the transfer of the loan agreement) or may need to be obtained at the time of the transfer as a condition for the effectiveness of such transfer.

Pursuant to the Consumer Credit Act, subject to certain exceptions, there is an obligation for the original lender to notify the borrower about the assignment of rights. The consent of the borrower of the assigned receivables for the assignment thereof may be needed only if it is so prescribed by the respective loan agreement.

Pursuant to the relevant regulations of the CNB, the originator is obliged to report a change of the creditor of the assigned receivable to the CNB if the new creditor is a non-resident, provided that the respective resident debtor is not made aware of such change in the creditor.

The transfer of rights and benefits from a contract needs to be exercised in accordance with the applicable data protection and GDPR-related regulations.

Special rules may apply in certain cases of transfer – for example, if the receivables are secured by a state guarantee, prior written consent from the Minister of Finance is required in order for the relevant transfer to be effective.

3.7 Debt Buy-Back

Debt buy-back is permitted by Croatian law and would generally result in the relevant debt ceasing to exist ex lege due to confusion (if the debt purchase is by the borrower). Acquisition of the debt by an affiliated entity may result in the application of thin capitalisation rules and/or rules on loans in lieu of the capital, which may have unwanted effects for such lender, particularly in the context of the potential (pre)bankruptcy of the borrower.

3.8 Public Acquisition Finance

Croatian law imposes a duty to negotiate in good faith. Subject to the circumstances listed below in the context of takeover bids, there is no legal or regulatory requirement to provide a "certain funds" confirmation, and such concept is used in acquisition transactions only if it is negotiated by the relevant parties. Therefore, what constitutes "certain funds" differs between transactions.

In certain acquisitions of shares in a public limited company (PLC) with a registered office in Croatia, whose voting shares are admitted to trading on a regulated market in Croatia or another EEA country, or the acquisition of shares in a PLC whose registered office is in another EEA country and whose voting shares are admitted to trading on a regulated market in an EEA country, when the takeover bid is published, the bidder is obliged to ensure the availability of the necessary funds for the payment for all outstanding target company shares by way of making a cash deposit on a separate account held by the Central Clearing and Depository Company, or obtaining an irrevocable and unconditional bank guarantee payable on first demand.

3.9 Recent Legal and Commercial Developments

As mentioned above, Croatia joined the euro area on 1 January 2023 and the fixed conversion rate was HRK7.53450 for EUR1. The introduction of the euro has eliminated foreign exchange risk in euro transactions with Croatian entities and, subsequently, the financing documents had to be amended by way of omitting the standard provisions for dealing with foreign currency matters and exchange rates.

The introduction of the euro does not affect the validity of existing contracts and other legal instruments expressed in Croatian kuna, and,

generally speaking, it has therefore not been necessary to sign addenda to existing contracts and other legal instruments.

3.10 Usury Laws

Currently, the rate of contractual interest between merchants may not exceed 21% per annum, and the rate of contractual interest in contracts involving non-merchant parties may not exceed 10.5% per annum, noting also that the effective interest rate in consumer loans cannot exceed 9% per annum and in consumer housing loans 7% per annum.

The default interest rate payable on due but unpaid amounts arising from contracts between merchants is currently 12% per annum, while for contracts involving non-merchant parties it is currently 7% per annum. The default interest rate may be contracted differently, with a maximum interest rate not exceeding the prescribed maximum rates (21% for contracts between merchants and 10.5% for contracts involving non-merchant parties).

As of 31 December 2022, the arm's length interest rate on loans between related parties for purposes of the corporate profit tax is 2.4% per annum.

3.11 Disclosure Requirements

The Act on the Right to Information Access is the primary act that prescribes which types of information and documents public authorities are required to publish on their websites to achieve financial transparency. For example, public authorities are obliged to disclose information about their source of funding, their budget, financial plan, or other relevant documents that determine their revenues and expenditures, as well as information and reports on budget execution. This also includes information about grants, sponsorships, donations, or other forms of assistance, including a list of beneficiaries and the amounts involved. Other regulations that deal with publication of financial documents include the Budget Act, the Public Procurement Act, the Accounting Act and the Act on Financial Operations and Accounting of Non-profit Organisations.

4. Tax

4.1 Withholding Tax

Pursuant to the Croatian Profit Tax Act, withholding tax (15% in principle and 10% for dividends) is levied on profits generated by a non-resident in Croatia and is charged on, inter alia, interest and dividends, copyright and other intellectual property rights, etc, paid to foreign entities that are not physical persons.

The withholding tax is not payable on:

- interest paid in relation to loans granted by foreign banks or other financial institutions;
- interest paid to foreign persons holding sovereign or corporate bonds; and
- interest paid in relation to commodity loans for the purchase of goods that are used by the taxpayer to carry on its business.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Subject to the stipulations in **4.1 Withholding Tax**, no stamp, registration or similar duty or tax is payable in the Republic of Croatia in respect of loan agreements and related security documents, apart from the fees and stamp duties for the solemnisation/notarisation of the Croatian law security and other documents being notarised and other related notary public actions and documents, and the stamp duties and/or

fees payable for the registration of the security interest over the security assets in the competent registry.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

When it comes to foreign lenders and non-money centre bank lenders, apart from withholding tax (please see **4.1 Withholding Tax**), certain additional potential tax considerations, such as thin capitalisation rules, transfer pricing, permanent establishment (PE) and foreign exchange control regulations shall be taken into account.

Thin capitalisation rules aim to limit the amount of interest deduction that a company can claim on loans from related parties. Therefore, a Croatian profit tax obligor is obliged to increase the income tax base for interest on loans received from a shareholder holding at least 25% of the shares or voting rights if, at any time during the tax period, those loans exceed four times the amount of the shares of that shareholder (in capital or voting rights) determined in relation to the amount and duration of the loans in the tax period (interest on loans granted by financial institutions are excluded). Under Croatian law, loans from third parties guaranteed by a shareholder and loans from affiliated entities are also considered shareholder loans. Additionally, interest expenses on loans between related companies is deductible up to the amount prescribed by the Ministry of Finance, as calculated and published by the CNB (in 2023, 2.4%). The Croatian Profit Tax Act also stipulates that interest costs and other costs of borrowing on loans received are tax deductible up to an amount of EUR3 million or 30% of profit before interest, taxes and depreciation (EBITDA), depending on whichever is higher. Therefore, when determining tax-deductible interest expenses, both the interest rate and the absolute amount must be considered. As these rules apply also to loans granted by foreign lenders, it is advisable to structure loans in a way that complies with such rules.

When it comes to transfer pricing, if the terms of the loan (interest rates, repayment terms, etc) are not in line with arm's length principles, Croatian tax authorities might adjust the transaction to reflect fair market value, impacting the deductibility of interest payments. Ensuring that the terms of the loan are well-documented and comply with arm's length principles can help mitigate transfer pricing risks.

Moreover, having a significant presence of a foreign lender in Croatia could potentially create a permanent establishment, leading to taxation of profits attributed to that establishment. Therefore, if, after a careful analysis, it transpires that the activities of a foreign lender could give rise to a permanent establishment, a potential strategy for alleviation should involve structuring the lending arrangement in a manner that mitigates such risks.

5. Guarantees and Security

5.1 Assets and Forms of Security

Security interests that have in rem effect are most commonly used in practice.

A security interest may be granted in the form of a pledge (or a mortgage in the case of real estate, a ship or an aircraft) or in the form of a fiduciary transfer of ownership of the relevant asset. There is also a possibility to enter into financial collateral arrangements. The pledge is a commonly used security instrument for various objects, including movables, shares, bank accounts, claims and intellectual property rights,

as well as any other right that is subject to the same legal regime applied to the movables.

Pledges

A pledge may be established as a registered or non-registered pledge.

A registered pledge may be granted through a security agreement executed before a court or before a notary public, and in each case followed by the registration of the pledge in the competent registry, or in the depository operated by the Central Depository & Clearing Company's registry for dematerialised shares in the share capital of a public limited company.

Generally, full perfection of the registered pledge takes place after the decision on the entry of the security interest in the registry becomes final, at which point it is deemed that the security interest has been created retroactively – ie, from the date of submission of the registration application.

In the case of a non-registered pledge, the creation of the respective security interest remains outside of the public domain, which represents a risk and is certainly less beneficial to the secured creditor.

In relation to the pledge of claims, the secured creditors commonly require the granting of the pledge to be notified to the counterparty(ies) (ie, the debtors of the pledged claims), and require the counterparty(ies) (if at all possible) to acknowledge the receipt of the notification and confirm they would act in accordance with the instructions given in the notice of pledge. As mentioned under **3.6 Loan Transfer Mechanisms**, taking security over the receivables owed by the state requires prior written consent from the Minister of Finance.

Fees

The fee for the registration of the collateral in the registry is approximately EUR40 per application, and it takes around eight days for a pledge to be registered.

The notary public's fees, duties and costs related to the granting of the security interest (provided the document is solemnised – ie, notarised as to content) depend on the amount of the secured claim.

Mortgages

A mortgage over real estate is created upon the entry thereof into the land registry of the competent court and is commonly used as a security interest. When it comes to mortgages (as well as any registered pledge), the principle of "first in time, first in right" applies.

The fee for the registration of the mortgage in the land registry is approximately EUR35 (no stamp duty is payable if registration is made based on a solemnised agreement), whilst the public notary's fees and duties are determined under the same rules as for the pledge.

Fiduciary Transfer of Ownership

A fiduciary transfer of ownership enables the secured creditor to become a fiduciary owner of the relevant assets, and to become a full owner thereof under certain conditions.

However, due to certain historical controversy, this type of security interest has not been seen in practice very often in the past ten years and, thus, is generally not recommendable.

Financial collateral arrangements were introduced into Croatian law via the Financial Collateral Law (FCL), which was adopted in 2007.

It is necessary to have evidence of the execution of the respective agreement and the delivery/acquisition of the collateral either in writing or in a durable electronic medium. The financial collateral is considered delivered/acquired once the title transfer or creation of a special pledge over the financial collateral is noted on the relevant account with the registry of financial instruments (in the case of securities collateral) or at the relevant bank account (in the case of cash collateral).

Analysis of the FCL reveals that uncertainty persists over the material scope of its application, as well as the definition of crucial terms, even at a rather basic level.

Information on the existence and/or scope of such arrangements is limited to contractual relationships between the parties; there is no reliable and complete publicly available information on the scope of such arrangements and the impact of their implementation on business practice.

5.2 Floating Charges and/or Similar Security Interests

The Croatian legal system recognises a floating pledge as a contractually created registered pledge of movables of all kind or movables of a specific kind (goods, inventory, spare parts, furniture, tools, etc), located in a specific place (eg, warehouse, factory, business premises) otherwise owned or leased by the debtor.

The main characteristic of the floating pledge is that a debtor (the owner of the relevant movables) retains control over the assets – ie, the debtor continues to be entitled to dispose of the movables subject to the floating pledge and a person who acquires the possession of such movables acquires it free of encumbrances (ie, free of floating pledges) as the floating pledge ceases to exist by the mere taking of the relevant movables out of the specific place/area. It should be noted that the provisions of the relevant law impose an obligation on the debtor to substitute the assets disposed with new ones in accordance with the nature of its business operations (unless that obligation is contractually excluded). Ultimately, the rights of the pledgee may be heavily affected if the debtor fails to act accordingly and effectively substitute the relevant assets promptly.

If the secured creditor initiates enforcement proceedings on the basis of the floating pledge, the relevant enforcement will effectively include all movables of a described type (vehicles, machinery, raw material, etc) found in the specific place/area set out in the pledge agreement at the moment the seizure list is created (in the course of enforcement proceedings).

5.3 Downstream, Upstream and Cross-Stream Guarantees

When granting any type of guarantee to foreign legal entities, Croatian companies must comply with certain additional obligations under the Croatian Foreign Exchange Act – please see **3.3 Restrictions and Controls on Foreign Currency Exchange**. In addition, pursuant to the Bankruptcy Act, if the appropriate security (or other type of consideration) is not provided to a guarantor, a guarantee may be considered to be of no value or no considerable value, and may be voided upon the insolvency of the respective guarantor.

Also, when granting guarantees, Croatian legal entities need to take the applicable capital maintenance rule contained in the Croatian Companies Act (CA) into consideration, as any support in whatever form from a company for the debt of the shareholder or its affiliated companies/

subsidiaries may also be considered as being contrary to the applicable capital maintenance rules, pursuant to which a company is generally not allowed to repay the paid-in capital to its shareholders (Article 217 of the CA).

According to Article 406 of the CA, shareholders are not entitled to request repayment from a company of their contribution to the share capital and, according to Article 407 of the CA, payments made to a shareholder from the company's assets that would be equal to the value of the company's share capital are not allowed. If the shareholder would receive a payment contrary to the rules prescribed by the CA, the company's articles of association or shareholder resolutions, such payment would be considered to be contrary to the capital maintenance rules, and the shareholder(s) would be obliged to return the payments made by the company.

If it is not possible to collect such prohibited payment that has reduced the value of the company's share capital, either from the shareholder(s) who received it or from the management board, other shareholder(s) shall be jointly liable for the decrease in the company's share capital, in proportion to their basic shares in the company, provided such funds are necessary for settling the creditor(s). Such request from the company becomes statute-barred five years after the receipt of such payment constituting a breach of the capital maintenance rules, unless the company can prove that the shareholder who received the payment knew it was not permitted.

Namely, the distribution of assets to shareholders outside of the regular distribution of profits is not allowed, so any potential subsequent payment by the company to the creditor on the account of the company's co-debtorship/security provided for the debts of its shareholder or its affiliated companies/subsidiaries may be construed as a breach of the applicable capital maintenance rules and thus as a prohibited payment. In practice, the respective guarantees often contain guarantee limitation wording specifying that the obligations and liabilities under the guarantee granted by a guarantor shall not include any liability to the extent it would result in payments made to the shareholders being considered contrary to the relevant provisions of the CA.

5.4 Restrictions on the Target

Subject to certain exceptions, the CA does not allow a target that is a Croatian PLC to support the acquisition of shares therein with the assets of that target. The consequence of any legal transaction that would be qualified as prohibited support is that the respective security interest would be considered null and void. If the respective financing transaction includes both the actual financing of the acquisition of shares in the target and other financing of the target, it is necessary for the acquisition financing facility to be separated from such other facility(ies), and for any security granted by the target to not relate to such acquisition financing.

While the aforementioned restriction is not prescribed for LLCs, the capital maintenance rules apply to both types of company.

5.5 Other Restrictions

Besides the restrictions noted in **5.4 Restrictions on Target**, actions like the granting of security, the issuing of a guarantee, the repayment of a loan and others may be subject to claw-back provisions contained in the Croatian Bankruptcy Act, which prescribes the conditions under which the bankruptcy administrator and bankruptcy creditors are entitled to challenge certain legal actions of a bankruptcy debtor taken dur-

ing the prescribed hardening period before the opening of the (pre)bankruptcy proceedings if such actions are deemed to disrupt the right of the balanced settlement of the bankruptcy creditors, or are taken in favour of certain bankruptcy creditors. The hardening periods vary between one month and ten years.

5.6 Release of Typical Forms of Security

Upon the repayment of the secured claim, a security release statement must be issued by the secured creditor in order for the deregistration of the mortgage and registered pledge to occur; this statement has to be notarised before the notary public, and the relevant deregistration application needs to be submitted to the competent registry and approved thereby.

5.7 Rules Governing the Priority of Competing Security Interests

The principle of "first in time, first in right" applies equally to a mortgage and a registered pledge.

Contractual subordination of certain claims is generally possible, but creditors entering into intercreditor arrangements and agreeing on different priority between different groups of lenders should not assume the insolvency court or the bankruptcy administrator would act in accordance with such contractual arrangements and distribute the respective proceeds according to the agreed waterfall provisions; instead, they should rely on the effectiveness of the relevant distribution provisions inter partes and outside of the bankruptcy/enforcement proceeding.

5.8 Priming Liens

In the Croatian legal system, certain security interests can arise by operation of law and those might take priority over a lender's security interest and, in that way, affect the lender's position in the case of a borrower's default.

For example, employees have a statutory lien over their employer's assets for unpaid wages and severance pay. Also, tax claims and claims of certain public authorities, as well as judicial liens resulting from court judgments, might take priority over the lender's security interests. Therefore, lenders should conduct thorough due diligence to identify existing priming liens, while borrowers should take steps to address any outstanding preferential claims before entering into financing arrangements. Usually, finance documents contain appropriate representations and warranties of the borrowers dealing with potential preferential claims.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Security interests may generally be enforced upon a default that leads to the occurrence of a payment default that remains unremedied. Depending on the type of security interest and security assets, and on the type of underlying obligation, and in each case subject to the contractual arrangements, enforcement may be conducted both out-of-court and before the court (eg, in the case of shares, claims, accounts, movables, etc) or solely in the enforcement procedure run by the court (eg, real estate). In each case, a proper enforcement title needs to be in place in order for the enforcement to be initiated, so it is market practice for a security document to be executed in the form of a notarial deed containing an appropriate enforcement clause allowing for direct enforcement (provided the contracted conditions are met), that way allowing the secured creditor to avoid having to obtain first a final and enforceable ruling from a competent authority and instead enabling the secured

creditor to directly start the relevant enforcement proceeding (out-of-court or before the court).

6.2 Foreign Law and Jurisdiction

The Private International Law Act came into force in 2019. As it completely adopts 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), it recognises the choice of foreign law to govern a contract containing an international element and involving a Croatian party (and any contractual obligations connected with such contract) as being effective on such Croatian party, and the choice of foreign law as the governing law of the relevant contract would generally be upheld as a valid choice by the courts of Croatia, subject to certain exceptions.

If the relevant foreign law-governed contract does not have an international element, it can still be governed by foreign law, but would remain subject to the mandatory rules of Croatian law. The Croatian courts may not uphold the choice of foreign law if the application of such law would result in an obvious violation of the Croatian public policy rules. Additionally, the Croatian courts may apply a provision of Croatian law that is considered to be of such high importance for the protection of the Croatian public interest that it is applicable to all situations that fall within its field of application, regardless of the law otherwise applicable.

Generally, provisions in a contract that provide for the submission by a Croatian party to a foreign court are valid, binding and enforceable on such Croatian party under the laws of the Republic of Croatia, to the extent that there is no exclusive competence of the Croatian court or other Croatian competent authority, and provided that at least one party in the dispute is an entity with a registered office outside the Republic of Croatia, or that another acceptable international element exists in relation to such dispute.

Waivers of immunity provisions are generally binding (unless otherwise prescribed by Croatian law) – ie, generally, all assets are available for enforcement unless they are indispensable to the performance of the party's activities and enforcement would result in the discontinuation of the party's business; such limitations do not apply in relation to the assets if the relevant entity explicitly agreed to the creation of the security interests over said assets. Special restrictions apply to the immunity applicable to the assets of the Republic of Croatia and local self-government (municipalities, cities and counties and their bodies).

6.3 Foreign Court Judgments

Different rules apply, depending on whether a judgment was given by the court of an EU or non-EU member state:

- recognition of a judgment given by a court of an EU member state is regulated by Regulation (EU) no 1215/2012 (Brussels I); and
- recognition of a judgment given by a court of a non-EU member state is regulated by the Croatian conflict of law rules; subject to certain exceptions, such judgments will be recognised and enforced in the Republic of Croatia.

An award of an arbitral tribunal seated in a jurisdiction that is a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958 – the New York Convention) may be recognised and enforced in the Republic of Croatia by the Croatian courts, in accordance with the provisions of the New York Convention.

6.4 A Foreign Lender's Ability to Enforce Its Rights

In a legal proceeding before a Croatian court, any relevant document that is in a language other than Croatian would have to be translated by a certified court interpreter into Croatian in order to become admissible in evidence in Croatia.

Under Croatian law, a creditor may be required to post security for the costs of the debtor (unless said creditor is domiciled in the EU). When it comes to loans with an international element, consumer loan debtors are protected by the Consumer Credit Act in proceedings on the nullity of loan agreements involving unauthorised creditors and/or credit agents.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

Once the bankruptcy proceeding has been opened, all creditors' claims towards the bankruptcy debtor become due. Creditors should report their claims to the bankruptcy administrator, and such claims may only be settled through the bankruptcy proceeding. All rights, authorisations and obligations of the debtor's corporate bodies, such as authorisations of the management board, etc, shall pass on to the bankruptcy administrator, who becomes authorised to represent the company and administer the bankruptcy estate. All assets of the bankruptcy debtor existing at the time of opening the bankruptcy proceeding form the bankruptcy debtor's bankruptcy estate.

The aforementioned is generally without prejudice to the rights of the creditors with the right to separate satisfaction (such as holders of pledges and mortgages) generally preserve their rights to separate satisfaction directly from the respective security assets.

7.2 Waterfall of Payments

Pursuant to the Croatian Bankruptcy Act, creditors are classified into payment ranks in the bankruptcy proceeding. The claims of creditors of a lower payment rank can only be settled after the creditors of the higher payment rank have been fully settled.

Within the same payment rank, creditors' claims are settled pro rata.

The first ranking claims include employees' and competent authorities' claims arising out of an employment relationship, such as salaries, contributions and related tax. All other claims against the bankruptcy debtor are considered claims of the second higher rank, unless they have been classified into a lower payment rank.

As mentioned above, creditors with the right to separate satisfaction (such as holders of pledges and mortgages) generally preserve their rights to separate satisfaction directly from the respective security assets.

7.3 Length of Insolvency Process and Recoveries

The insolvency proceedings and their outcomes can vary widely depending on the complexity of the case, the specific circumstances of the bankrupt company, and the efficiency of the legal and administrative systems in place.

According to the Ministry of Justice and Administration Statistical overview of the work of the courts for the year 2022 in relation to the commercial courts being in charge of bankruptcy proceedings, it appears that, formally speaking, the resolution time for such a proceeding was

238 days in 2022 and the duration appears to have decreased in comparison to the previous year. However, that data is merely an average of the duration of the bankruptcy proceedings, which appears to be quite short and efficient, but only as a result of the fact that a significant number of bankruptcy proceedings are closed immediately after being opened as a result of a lack of any assets owned by the relevant bankruptcy debtor which could be used to settle the creditors.

In reality, bankruptcy proceedings for the insolvent operating companies with assets and ongoing business tend to last for years.

There is no official data on the recovery rate but generally, the average recovery rate for bankruptcy (unsecured) creditors appears to be quite low (around 35%, according to the World Bank Doing Business 2020) and significantly below EU average.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Under the Croatian Bankruptcy Act, the restructuring of companies outside of bankruptcy proceedings is possible through the pre-bankruptcy proceeding. Croatian law also recognises the restructuring of companies through the bankruptcy proceeding, either via the bankruptcy plan, which is most commonly seen in practice, or, on an exceptional basis, through a self-administration proceeding within the bankruptcy proceeding.

Pre-bankruptcy

Generally, the most common method of voluntary reorganisation is through pre-bankruptcy. The debtor can initiate pre-bankruptcy proceedings if it is considered imminently insolvent.

Pre-bankruptcy is effectively always voluntary, as it is initiated directly by the debtor. Such procedure was introduced into Croatian legislation with the purpose of allowing the restructuring of illiquid companies with a business perspective, but without initiating a rather ineffective, long-lasting bankruptcy procedure carried out by a bankruptcy manager. Unlike the bankruptcy procedure, in the pre-bankruptcy procedure the company is run by the management appointed by the shareholders.

The essential legal effects of opening pre-bankruptcy proceedings include the following:

- all creditors are obliged to report their claims within the deadline determined in the decision on the opening of the proceedings;
- the debtor can only make payments related to the ordinary course of business, and in relation to supplies made after the opening of pre-bankruptcy (such legal effect arises upon submission of the application for opening the pre- bankruptcy procedure);
- without prejudice to the secured creditors' rights, the initiation of litigation, enforcement or administrative proceedings or proceedings aimed at securing claims against the debtor is prohibited, and all ongoing proceedings shall be suspended; and
- the seizure of funds on the debtor's accounts is suspended, except with respect to claims related to salaries, severance payments and temporary injunctions issued in criminal proceedings.

Management retains its representation powers in pre-bankruptcy proceedings, but may exercise only those powers that fall within the scope of the ordinary course of business. The debtor may dispose of its assets only with the prior approval

of the pre-bankruptcy trustee or the court; otherwise, such transactions have no legal effect.

The pre-bankruptcy proceeding may only last up to 120 days from the date of its opening; in exceptional circumstances only, the court may allow a prolongation for a further 180 days, upon the debtor's proposal. If the pre-bankruptcy agreement is not entered into within such time, it will be suspended by the court. If the creditors accept the restructuring plan and the debtor gives their consent, the court would decide to accept the restructuring plan and confirm the pre-bankruptcy agreement, subject to certain exemptions prescribed by the Bankruptcy Act, in which the court may nevertheless decide not to adopt a decision and confirm the pre-bankruptcy agreement.

7.5 Risk Areas for Lenders

Bankruptcy proceedings are usually time-consuming, and satisfaction of the creditors (even secured creditors) is subject to a significant time delay. Satisfactory repayment of the debt is rare.

Moreover, under the Bankruptcy Act, there are a number of circumstances under which legal actions of the debtor that have been taken prior to the opening of bankruptcy proceedings that either undermine the right to even satisfaction of the creditors (creditors' damage) or put certain creditors in a more favourable position (preferential treatment of creditors) may be challenged by the bankruptcy administrator and other creditors by a lawsuit, in which case further significant costs and delay may be expected. The respective hardening period can vary between one month and ten years, depending on the circumstances.

8. Project Finance

8.1 Recent Project Finance Activity

Croatia has seen varying levels of project finance activity across different industries. Historically, projects in the sectors of energy, municipal and environmental infrastructure, telecommunications, media and technology and transport have shown the most significant level of project finance in Croatia.

8.2 Public-Private Partnership Transactions

The legal framework relating to PPP transactions (in the wider sense of that concept) includes the following:

- the special PPP Act and related secondary regulations;
- the Concessions Act and a number of sector-specific laws and regulations dealing with sector-specific concessions (roads, airports, sea ports, etc) that are relevant in PPP projects that require a concession to be awarded;
- the Public Procurement Act; and
- other relevant laws and regulations otherwise applicable to projects in specific sectors.

A PPP is defined as a long-term contractual relationship between the public and the private partner, the subject of which is the construction and/or reconstruction of public infrastructure for the purpose of rendering public services otherwise being within the public partner's competence, whereby the private partner assumes:

- obligations and risks regarding the building process from the public partner during the implementation of a PPP project; and
- one or both of public building availability risk and demand risk.

In accordance with the purpose of a PPP project, a public body may allow the performance of commercial activities intended to collect revenues from third parties in the market. Pursuant to the PPP Act, PPP projects are implemented via two models: a contractual PPP model and an institutional PPP model.

The maximum contracted period may vary from three to 40 years, unless a longer period is allowed by a particular sector law.

Although clearly, the concept of PPPs is recognised in Croatia, its wider implementation has faced certain challenges, including lack of political will, sufficient administrative capacities and experience in the implementation of PPP projects, lack of awareness or misunderstandings about the benefits of PPPs and issues with public perception and acceptance of PPPs. As a result, the progress in implementing PPP projects in Croatia is very limited.

8.3 Governing Law

Please see **6.2 Foreign Law and Jurisdiction** which generally applies to project documents as well, noting that project documents like power purchase agreements and offtake contracts involving public entities tend to be rather simple, standardised and governed by Croatian law with jurisdiction of Croatian courts.

8.4 Foreign Ownership

A foreign individual wishing to acquire ownership of real estate in Croatia has the right to do so only on the basis of the prior approval issued by the Ministry of Justice and Administration and provided there exists a reciprocal opportunity for Croatian individuals in that country. This restriction does not apply to citizens and legal entities from European Union member states Island, Liechtenstein and Norway, as they acquire the right of property ownership of real estate under conditions that apply to the acquisition of property ownership rights for Croatian citizens and legal entities registered in the Republic of Croatia. Generally, a foreign investor can establish a company in Croatia which, as a Croatian legal entity, can acquire real estate without limitations.

Pursuant to Croatian law, no real rights or lease can exist on maritime domain on any grounds. Public water domain is owned by the Republic of Croatia and it cannot be disposed of.

There are no restrictions for the foreign lenders to acquire security interests over real estate in Croatia.

8.5 Structuring Deals

The legal framework for investments is provided in the Investment Promotion Act, the Strategic Investment Projects Act, the Companies Act and other applicable regulations.

The Strategic Investment Projects Act provides measures aiming to shorten and accelerate the licensing procedure for public and private investment projects as well as for PPP investment projects of strategic interest for Croatia.

Legal entities registered in Croatia are considered to be domestic legal entities, regardless of who the shareholders are and the origin of the capital. As a general rule, foreign investments are not subject to restrictions under Croatian law, but certain strategic sectors or assets/sources are either subject to restrictions that apply generally, regardless of the citizenship of the acquirer (eg, maritime domain), or are subject to restrictions that apply to persons who do not have Croatian or other EU country citizenship, or that in certain cases apply to all foreigners.

In practice, most project companies are established in the form of an LLC, as the incorporation and operation of such companies are the simplest, and they are sufficiently flexible and straightforward.

Foreign investments and financing by foreign lenders may, depending on the circumstances (amount of loan, percentage of shares/control as a result of investment, sector, etc), be subject to certain reporting obligations, including to the CNB, tax authorities, Croatian Bureau of Statistics and the ultimate beneficial owners register.

The main risks to be taken into consideration when structuring a project finance transaction in Croatia are primarily legal and technical aspects, political aspects and commercial risks, including credit and repayment risk. In order to try to mitigate some of these risks, it is common to conduct an adequately detailed due diligence dealing with the relevant areas, and it is often advisable to engage experienced (local) professionals with respect to the most critical areas (depending on the type of the project).

8.6 Common Financing Sources and Typical Structures

Typical financing sources for project finance include bank financing and equity. In addition, major projects are being financed through EU funds or by way of financing by the European Investment Bank, the European Bank for Reconstruction and Development and the Croatian Bank for Reconstruction and Development. Project bonds are rarely used in practice.

8.7 Natural Resources

Croatian legislation sets out various restrictions relating to natural resources, ranging from the general exclusion of certain natural resources from any trade or ownership (eg, air and water in rivers, lakes and seas, as well as the seashore) (common good) to specific measures adopted for certain categories of natural resources.

Certain restrictions apply generally, regardless of the jurisdiction of the acquirer. For example, a right of ownership or any other property right cannot be acquired on a maritime domain on any basis, as it represents a common good managed by and of interest for the Republic of Croatia.

Additional acquisition and export restrictions may apply, depending on the category of natural resources in question, so Croatian and foreign investors should seek reliable legal advice in this respect prior to acquiring any such properties.

8.8 Environmental, Health and Safety Laws

The environmental legal framework for projects consists of EU-harmonised legislation, and includes the Environmental Protection Act and various other laws and regulations. Any project that might have a significant impact on the environment must be assessed.

At a national level, the tasks of the Ministry of Economy and Sustainable Development focus on the protection and conservation of the environment and nature, in line with the sustainable development policy of the Republic of Croatia, and on water management and administrative and other tasks from the field of energy. At a regional level, the competent administrative body in the county or the City of Zagreb and other state administrative and expert organisations/institutions deal with various environmental protection matters within the scope of their responsibilities.

Health and safety issues are primarily regulated by the Law on Occupational Health and Safety.

The Ministry of Labour, Pension System, Family and Social Policy is the main administrative body for health and safety at work in the Republic of Croatia, with the involvement of additional institutions included in the implementation of health and safety at work. In this respect, the Labour Inspection Sector of the State Inspectorate monitors the application of laws and other regulations in the field of labour relations and safety at work, while the Croatian Institute of Public Health – Department of Occupational Health provides professional assistance.

CYPRUS

Law and Practice

Contributed by:
Kyriacos Scordis, Sofia Tryfonos Avraam and Anna Borovska
SCORDIS, PAPAPETROU & Co LLC

Contents

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SCORDIS, PAPAPETROU & Co LLC

SCORDIS, PAPAPETROU & Co LLC is a leading and dynamic Cyprus law firm whose roots date from the practice established by the late Andreas Michaelides in 1922 in Famagusta and later the respective practices of Andis Scordis, Michalis Papapetrou and Adamos Adamides. Today, the firm offers, together with its affiliates and subsidiaries, in addition to other traditional services of a law firm, a wide range of services, such as international litigation, arbitration and dispute resolution, corporate and commercial, M&A, estate and tax planning and trusts, company/fund formation and administration, fiduciary and trustee services, accounting and tax advisory.

Authors

Kyriacos Scordis is the managing partner of SCORDIS PAPAPETROU & Co LLC, who focuses on public and private M&A, group reorganisations, banking and finance, general company law and corporate governance matters, international cross-border matters and other corporate transactions. He is a member of Lincoln's Inn, Inns of Court (Barrister at Law), the Cyprus Bar Association, the International Tax Planning Association, the International Association of Young Lawyers (AIJA) and the International Bar Association.

Sofia Tryfonos Avraam is a partner of SCORDIS PAPAPETROU & Co LLC with numerous years of experience. She is active in M&A, banking and finance, general company law and other corporate and commercial transactions. She is a practising solicitor of the Supreme Court of Justice of England and Wales, a member of the Law Society and a member of the Cyprus Bar Association.

Anna Borovska is currently a junior associate of SCORDIS PAPAPETROU & Co LLC, who officially joined the team after the successful completion of her pupillage at the firm's offices. Having completed her LPC studies, she progressed in becoming a member of the Cyprus Bar. She is part of the corporate and commercial department and is involved in various transactional projects supporting the lead partners of the department.

Contributed by: Kyriacos Scordis, Sofia Tryfonos Avraam and Anna Borovska,
SCORDIS, PAPAPETROU & Co LLC

SCORDIS, PAPAPETROU & Co LLC

30 Karpenisiou Street
1077Nicosia
Cyprus

Tel: +357 22 843 000
Fax: +357 22 843 444
Email: info@scordispapapetrou.com
Web: www.scordispapapetrou.com

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

The Cypriot economy has continued to record a noteworthy growth, mainly driven by a faster than expected recovery in tourism-related activities and, to a lesser extent, by growth in information and communication activities and in professional services. In addition, the credit rating of Cyprus has also improved, which in turn has aided banks, financial institutions and private companies to raise capital, uphold strong capital positions and reduce the amount of non-performing loans (NPLs). Since the 2013 banking crisis, the banking sector had to restructure the way it functions, by refining and strengthening its capital and investing in its corporate governance. All domestic banks have been under the supervision of the European Central Bank (ECB) and gone through various stringent assessments that have successfully created more robust and steady foundations.

A popular trend in the market has been the consolidation of businesses via mergers and acquisitions, including in the financial sector with larger banks acquiring smaller ones, whilst particular divisions handling the management of NPLs have improved lending conditions in general.

Reforms, New Laws and Current Trends

Reforms of the island's legal and judicial structure include the new state scheme (ESTIA) which aims to support vulnerable borrowers who are encountering financial problems repaying their loans backed by main residences.

The Securitisation of Credit Facilities or Other Forms of Claims or Exposures Law (88(I)/2018) (the "Securitisation Law") passed in 2018, enables a lender to refinance a set of loans, exposures or receivables by transforming them into tradeable securities accessible to investors. Its goal is to ease the minor loan market, and hopefully, ultimately, reduce the number of NPLs.

The 2013 banking crisis made obtaining loans from banks more challenging due to increasingly stringent procedures and checks. Even though new lending increased in 2019 (mainly to non- financial corporations) the private sector continued to rely on internal resources and foreign funding, as new lending from domestic banks was still constrained by large proportions

of non-performing loans, elevated debt and tighter credit standards.

1.2 Impact of the Ukraine War

The war's immediate impact does not appear to represent a threat to the domestic banking industry, as exposure of the Cypriot banking sector to the Russian market or sanctioned individuals is limited. In particular, Russian nationals account for only 0.8% of total loans and 4.7% of total deposits.

Additionally, according to ECB data, in the second quarter of 2022, Cypriot banks had, and continue to have, one of the highest liquidity coverage ratios in Europe, at 314%, and should be able to absorb any liquidity outflows.

1.3 The High-Yield Market

The issue of corporate bonds other than to related parties is not a common feature in Cyprus, at least outside the banking sector (eg, in June 2023 Bank of Cyprus issued EUR220 million Fixed Rate Reset Perpetual Additional Tier 1 (AT1) Capital Securities, and a concurrent cash tender offer to holders of its outstanding additional Tier 1 Capital securities). Having said this, the exposure to the high-yield market is likely to attract other large corporations keen to tap into it as a replacement to shareholder equity, bank or trade finance, which are the current financing tools used.

1.4 Alternative Credit Providers

The search for financial channels outside the traditional finance system in Cyprus is showing tendencies for growth, with particular emphasis on credit arrangements via retailers promoting own arrangements or those of particular suppliers of goods or services and limited leasing schemes. The provision of peer-to-peer financing or B2B is less straightforward and the sector is restricted due to Central Bank of Cyprus (CBC) regulations and guidance that restrict non-banking or equivalent institution financing.

1.5 Banking and Finance Techniques

The Cypriot banking crisis of 2013 and the subsequent reforms in the banking sector, aimed at addressing the challenges facing the banking system, have resulted in the banks being very cautious towards new lending. In addition, the CBC, as aforesaid, has restricted the use of B2B or peer-to-peer financing from being processed via the banking sector. Banks now tend to seek to not only over-collateralise their exposure but to seek increasing levels of comfort regarding the underlying repayment ability. This in turn has meant that the application approval rate has fallen and an increase in turnaround times (and corresponding overheads). The management and sale of NPLs has remained a topic of ongoing discussion in the market with some progress in respect of this.

Whilst the measures are meant to reassure investors, this has not been reflected in stock exchange pricing trends, with banking stocks continuing to fall.

Aside from this, as well as the increasing use of retail-sector financing, there has not been any other significant alteration in the banking and finance techniques to date.

1.6 ESG/Sustainability-Linked Lending

The emerging sector of environmental, social and governance (ESG) investments and interest in sustainable lending is a trending topic, albeit one that does not seem to be a primary driver for or element in investments in Cyprus yet (even if all or some of the aforesaid elements are part

of a review of a prospective investment). Having said this, there is a build-up of momentum due to the announced commitment of the USA to achieve neutrality targets and the EU Sustainable Finance Disclosure Regulation (SFDR), which came into effect in 2021, and the EU Non-Financial Reporting Regulation (NFRR) of 2018.

The SFDR has imposed harmonised transparency and disclosure requirements on financial market participants and financial advisers and entails companies within that ambit to contemplate how sustainability risks are merged into the investment decision-making process as well as how remunerations are aligned with a company's sustainability matters. Therefore, the SFDR affects a majority of the financial services industry in Cyprus. The Cyprus Securities and Exchange Commission (CySEC) has confirmed that supervised entities need to fully comply with the SFDR disclosure obligations and with their ESG commitments, as they will be closely monitored.

CySEC has reinstated its mission to nurture compliance with sustainable finance standards.

As a result, the discussion around ESG in Cyprus has increased significantly, with the financial regulators, financial services organisations, banks and investment funds preparing to conform with the above EU directives, in addition to applying effective procedures, but such interest is primarily limited to larger (mostly listed) companies and banks.

As an example, one of the larger local banks has already received an "A" rating from the Morgan Stanley Capital International (MSCI), the global benchmark on ESG.

2. Authorisation

2.1 Providing Financing to a Company

Under the Business of Credit Institutions Law of 1997 (Law No 66(I)/1997, as amended) (the "Credit Business Law"), banks require a licence to conduct banking services.

The application for obtaining a banking licence should be made in writing by or on behalf of the applicant to the Central Bank of Cyprus (CBC) and no application fee is payable. Such application form must be accompanied by a business plan describing the types of activities envisioned and the organisational framework intended. In addition, relevant questionnaires which are issued by the CBC for the licensing of banks in the Republic of Cyprus need to be appropriately filled in and in general the CBC can request additional details prior to deciding whether to approve the application.

In order to be granted a banking business, the applicant must be either a legal person set up in Cyprus under the Companies Law, Chapter 113 (the "Companies Law") as amended, or a credit institution established and approved in its relevant country. If the applicant is not an existing EU credit institution, it must have initial capital of at least EUR5 million (meeting the capital requirements as set out in EU Regulation 575/2013 on prudential requirements for credit institutions and investment firms), although there may be specific situations where the CBC will consider allowing for a smaller initial capital.

Although the process is managed by the CBC, the ultimate decision-making powers on whether to grant relevant authorisation vest with the ECB.

EU Credit Institutions and Non-banks

The aforementioned criteria do not apply to EU credit institutions wishing to establish a branch in Cyprus, since credit institutions licensed by competent authorities of another EU member state may, under the provisions of Section 10A of the Credit Business Law, establish a branch in Cyprus without the need to obtain a banking business licence from the CBC.

With regard to non-banks, the Investment Services and the Exercise of Investment Activities, the operation of Regulated Markets Law and other related matters (87 (I)/2017, as amended) provides guidance as to the corporations and institutions capable of providing financial services. Such non-banks include any licensed Cyprus Investment Firms (CIFs), which require the prior approval and authorisation of CySEC. The requirements for a CIF depend on the specific type of investment and financial services provided by such company.

An investment firm originating from another member state or a third country is able to provide such services in Cyprus through its branch, provided it is authorised and overseen by a competent authority in that member state or third country and it complies with all the disclosure requirements of CySEC.

Finally, it is noted that private lending (eg, peer-to-peer or similar) or cross-border lending does not fall within the above framework, but under general principles of commercial law.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Foreign lenders are not restricted from granting loans provided doing so is compliant with the laws of their own jurisdiction and this does not amount to doing business in Cyprus as a financial institution (ie, falls under the definition of offering banking services). The latter generally means retail banking, as opposed to the provision of one-off financing.

3.2 Restrictions on Foreign Lenders Receiving Security

Borrowers are not restricted from granting security over any type of property, or guarantees to foreign lenders, nor providing from foreign subsidiaries of the borrower provided there are no such restrictions in their constituent documents, the Companies Law or other provisions (such as AML regulations).

3.3 Restrictions and Controls on Foreign Currency Exchange

There are no foreign currency exchange controls or restrictions as Cyprus is a euro area member state. Local borrowers are not restricted from borrowing in any foreign currency. Temporary restrictive measures were only imposed under the Enforcement of Restrictive Measures on Transactions in case of Emergency Law No 12(I) of 2013 for a limited period of time. Further, the Movement of Capital Law No 115(I) of 2003 ensures that there are no restrictions on the movement of capital, including payments to and from residents of Cyprus and residents of the EU or third countries. See **3.4 Restrictions on the Borrower's Use of Proceeds**.

3.4 Restrictions on the Borrower's Use of Proceeds

Obviously, the proceeds must be used for legitimate purposes and subject to any restrictions imposed by the financing documents themselves. The effect of a borrower acting contrary to the approved purpose may, depending on the circumstances, cause the contract to be void by reason of the objects being unlawful in part, or voidable at the option of the lender whose consent was caused by fraud or misrepresentation, under the Cyprus Contract Law, Chapter 149 (the "Contract Law"). In addition, the use of such proceeds must always comply with the scope of activities of the borrower as these are stated in its memorandum of association, and must comply with general principles of contract law as well as specific restrictions/prohibitions that may exist under relevant applicable law.

Further, Cyprus is a full member of the European Union and the United Nations, and applies, enforces and implements any international sanctions by a relevant decision or resolution adopted by the UN Security Council, and restrictive measures adopted by the Council of the EU via relevant decisions and regulations, within the framework of Common Foreign and Security Policy. Therefore, for example, the use of proceeds to make or be part of any arrangement to provide loans or credit to, or enter into any transactions or dealings with certain financial instruments with, any legal person, entity or body on any such sanctions list (or any legal person, entity or body majority-owned by such sanctioned person, or acting on behalf of such sanctioned person) is prohibited.

3.5 Agent and Trust Concepts

Both the agent and trust concepts are recognised in Cyprus. Agency law is generally governed by several pieces of legislation, including Sections 142–198 of the Contract Law, which ultimately mirror English common law.

Likewise, trusts are of common law application and the relevant domestic law is the Trustees Law, Chapter 193, as amended, and the International Trusts Law of 1992 (No 69(I)/1992), as amended. The general idea of a trust is that it creates a fiduciary relationship where the trustee holds title to a property for the benefit of a third party. Thus, a trust can also be used to hold security over the possessions of debtors on behalf of creditors.

An alternative concept, which falls between the two and is commonly used in financing/banking as well as commercial transactions, is that of the escrow agent, whereby the escrow agent assumes the role of both a trustee and an agent for both parties, in order to facilitate the conclusion of a transaction.

3.6 Loan Transfer Mechanisms

There is no statutory mechanism. The loan documentation will usually provide that the lender may freely assign its rights and obligations to a new lender; the borrower will not usually be allowed to novate its obligations without the prior express or written consent of the lender.

With respect to securities granted to the original lender, these may be either released with the simultaneous execution of termination agreements with respect to the existing security agreements between the borrower and the original lender, and the new security agreements between the borrower and the new lender as secured party (or a tripartite agreement between the borrower, the original lender and the new lender), or transferred without release in favour of the new lender. The process is regulated by general principles of law and the Contracts Law.

3.7 Debt Buy-Back

There are no general statutory restrictions; it is a matter of commercial terms (existence or negotiation) and capacity under the constituent documents of the parties involved. There may be instances of specific restrictions (such as when the buy-back by an affiliate amounts to financial assistance) and therefore each case needs to be examined on its particular facts.

3.8 Public Acquisition Finance

With respect to public takeover bids pursuant to the Public Takeover Bids Law 41 (I) of 2007 (as amended), for the acquisition of securities of companies (or a squeeze-out or a sell-out) it is possible to offer securities, cash or a combination of both. The consideration must be equal to at least the highest price paid or agreed to be paid for the same securities by the offeror, within 12 months before the bid announcement.

When a bid is made for a cash consideration, the bidding party must, in support of the bid, provide confirmations by (i) its board of directors, and (ii) one or more credit (or other) institutions with the necessary solvency (determinable by the regulatory authority with respect to public takeover bids, CySec), that the cash is and will remain available to such institution until the day of payment with respect to the bid. In the absence of such confirmations, CySec shall reject the takeover bid documents. The public offer documents are mandatorily submitted to the commission and the board of the offeree company, and will be made available to the holders of securities subject to the bid following securing the approval of the commission to publish the same, and is announced in at least two daily newspapers with national circulation.

3.9 Recent Legal and Commercial Developments

There have been no major developments that necessitate anything other than the customary ongoing refinement of legal documentation.

3.10 Usury Laws

Usury principles are contained in the Criminal Code, Chapter 154, (the "Criminal Code") which prohibits the receiving, charging and/or collecting of interest at a higher rate than the interest rate ceiling during the provision of any loan period, except credit institutions. The CBC must calculate the interest rate ceiling every three months, which is then published in the Official Gazette of the Republic of Cyprus.

Usury is punishable upon conviction with a fine not exceeding EUR30,000 and/or imprisonment not exceeding five years. Banking regulations also prohibit the charging of interest on interest (double counting) and general contractual principles render void/unenforceable provisions that are penalty clauses in disguise.

3.11 Disclosure Requirements

The EU Council Directive 2011/16 on cross-border tax arrangements, often known as DAC6, is applicable.

DAC6 applies to cross-border tax arrangements that satisfy one or more defined features (hallmarks) and include more than one EU nation or an EU country and a non-EU country. DAC6 requires EU-based intermediaries (including banks) or taxpayers to declare certain cross-border arrangements to their domestic tax authority, which must subsequently communicate the information with the tax authorities of all other EU member states if implementation begins on or after 25 June 2018.

4. Tax

4.1 Withholding Tax

Repayments of loans to the lender (whether located within or outside Cyprus, including interest repayments), would not be subject to Cyprus withholding tax deductions, as Cyprus does not levy withholding tax on such payments. At the same time, interest earned (eg, from deposits or a B2B arrangement) may be subject to either Special Defence Contribution tax (SDC) if passive income (at 30% from either a corporate or personal taxation perspective) or Income Tax (corporate stands at 12.5%; personal income tax varies depending on the tax bracket of the individual in question).

4.2 Other Taxes, Duties, Charges or Tax Considerations

All agreements concerning property situated in Cyprus or involving things or acts to be done in Cyprus are subject to stamp duty, the maximum stamp duty payable on a single agreement (usually the loan agreement) being EUR20,000, with all ancillary agreements thereto (such as the security documents) being stamped at EUR2 each. The Commissioner for Stamp Duty has a discretion to exempt an agreement from stamp duty if the agreement is considered as referring to property which is not situated in Cyprus or is an ancillary agreement relating to transactions taking place outside of Cyprus, however, it is common practice for the Commissioner to impose stamp duty on security agreements if the chargor is located within Cyprus, irrespective of whether the loan facility agreement is entered into between a lender and a borrower, both of whom are incorporated and/or situated outside Cyprus. In such case, the loan facility agreement itself is not subject to stamp duty, however the security agreements are stamped with one applicable stamp duty, and the others if in relation to the same transaction at a fee of EUR2.

Registration of a charge which is registerable with the Cyprus Registrar of Companies is subject to a flat registration fee of EUR680.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Cyprus does not apply any withholding tax on interest paid to non-residents. Any interest received by local tax residents is subject to either Income Tax or SDC. There are no tax concerns for foreign lenders as there are no restrictions on payment of interest to parties in other jurisdictions, beyond perhaps a volume of activity that may amount to the creation of a (taxable) permanent establishment in Cyprus or if they carry on their lending activity through a fixed place of business within the Republic or via a special purpose vehicle (Cypriot company) in the Republic to undertake the specific loan activity.

There are no requirements to deduct or withhold tax from the proceeds of a claim under a guarantee or the proceeds of enforcing security.

5. Guarantees and Security

5.1 Assets and Forms of Security

Typically, the assets that are used as collateral to lenders are immovable property (real estate), tangible movable property (eg, goods, stock, equipment and ships), financial instruments such as shares, bonds, receivables, present or future cash and intellectual property. The security usually takes the form of an encumbrance or charge/pledge over the asset depending on its nature.

Where the security is financial collateral, no formalities exist under Section 90 of the Companies Law and the requirements contained in Section 138 of the Contract Law do not apply.

The formalities are outlined in more detail in **5.5 Other Restrictions**.

5.2 Floating Charges and/or Similar Security Interests

Generally, no restrictions exist on the type of assets over which a security can be fixed unless it is a future asset, in which case any type of security can be granted (including a floating charge), besides a legal mortgage and a pledge. Likewise, any security can be fixed over interchangeable assets, besides a legal mortgage.

5.3 Downstream, Upstream and Cross-Stream Guarantees

It is possible for corporate entities to provide downstream, upstream and cross-stream guarantees as long as the guarantee is in accordance with Section 53 of the Companies Law (financial assistance) and as long as they have the necessary corporate power to do so. Section 53 provides whitewash provisions regarding unlawful financial assistance of private companies. Specifically, the provision of direct or indirect financial assistance by a private company for acquisition of its own shares or of the shares of its holding company is not unlawful in cases where:

- such private company is not a subsidiary of any public company; and
- the relevant transaction is approved by the general meeting of the company by a resolution passed by a majority of 90% of all the issued shares of the company.

It is important to highlight that the general prohibition on the provision of financial assistance by a public company for acquisition of its own shares still exists.

Further, it is noted that the whitewash provisions do not affect the obligation to comply with any other legal obligations, such as when acting as a guarantor, the directors of a company owe a duty to their company to act in good faith for the benefit of the company. The company's benefit from acting as a guarantor should be established.

5.4 Restrictions on the Target

See **5.3 Downstream, Upstream and Cross-Stream Guarantees**.

5.5 Other Restrictions

Security

Charges (fixed or floating)

This is a common form of security taken over movable property. If the chargor is a Cyprus legal entity, then the charge must be registered with the Registrar of Companies (RoC) within the given statutory timeframe, on the prescribed HE24 form and accompanied with the relevant fee. If a charge is not registered appropriately, it will be invalid against a future liquidator of the legal entity chargor.

Liens

Liens can arise under common law or equitable principles with no formalities being observed, although a contract may explicitly provide for a lien.

Mortgages

Mortgages are a common form of security taken over property such as real estate, vessels and ships. The lender obtains a right in rem over the property. If a mortgage is not properly registered with the RoC within the time limit set out by the Companies Law, then the mortgage will be void

against a liquidator or creditor of the mortgagor company.

Pledges

A pledge of shares of a Cypriot company is not registrable for perfection purposes. However, if a pledge has been taken over a foreign company's shares by a Cypriot-registered company, then the pledge has to be registered as a charge with the RoC to be perfected and valid against a liquidator of the pledgor. In addition, a pledge can be created over any kind of movable property.

The formalities for a pledge of shares of a Cypriot company, in order to be valid and enforceable according to Section 138 of the Contract Law are:

- it must be in writing, signed by the pledgor and the pledgee, and have at least two witnesses;
- the pledgee must give notice of the pledge to the company whose shares are being pledged;
- a memorandum of the pledge has to be added in the members' register of the company whose shares are being pledged; and
- the company must issue and deliver to the pledgee a certificate executed by the appropriate official of the company confirming the fact of the registration of the pledge in favour of the pledgee.

No formalities are applicable when a security is financial collateral, and the requirements contained in the Contract Law are not relevant.

Guarantee

Usually, a company offers guarantees as security for money owed on behalf of itself or a third party. In order for a company to grant a guarantee, it must have the adequate corporate power to do so and if it does not, the corporate guarantor must show that it will have a corporate benefit in giving the guarantee and that it serves its commercial and business interests. Furthermore, guarantees are usually formed by way of a written agreement and are bound to the contractual principles agreed between the parties themselves.

5.6 Release of Typical Forms of Security

A security is usually released via an agreement between the relevant parties. If, however, a security is registered as a charge under the Companies Law, then the RoC may release the security, either on whole or partial repayment of the secured debt. Filing the release with the RoC is a formality and it does not affect the validity of release.

Releasing a legal mortgage over immovable property occurs when the mortgagor and the mortgagee present the district lands office with the necessary documentation, according to the Transfer and Mortgages Law. In case a mortgagee does not release the mortgage, even after the discharge of secured obligations, then a court order to cancel the mortgage can be obtained by the mortgagor.

Procedures for the termination of a share pledge are specified in the pledge agreement and usually occur when:

- when the secured obligations have been discharged in full;
- via written agreement of the pledgee and the pledgor;
- the pledgee has served a termination notice on the pledgor; or
- there has been enforcement of the pledge by the pledgee.

Following termination, the pledgee returns the pledge security documents to the pledgor and the secretary of the company whose shares were pledged is instructed to delete the memorandum of pledge against the pledged shares in the register of members.

5.7 Rules Governing the Priority of Competing Security Interests

Competing Security Interests

The priority of competing security interests is governed by the principles of common law. In general, priority is determined by the time of creation and the type of security interest created. For example, a fixed charge will have priority over a floating charge, and if the security interests are of the same kind (eg, two legal fixed charges) then the earlier security will take priority.

The rules of priority are subject to limitations arising from insolvency laws.

Subordination

Various methods of contractual subordination are used in Cyprus to determine which lenders are the first eligible ones to receive interest and repayments, and which ones have first claim over loan collateral. Generally, the "senior" lender has priority over any other "junior" lender, whose interest is thus "subordinated" and entitled to interest, repayment or the collateral only once the "senior" lender's claim is satisfied in full.

Contractual subordination of debt is common in lending transactions and can be achieved by having a contractual agreement between the senior lender, junior lender and borrower.

Structural subordination is another method used to arrange the priority of debts. This is done by concentrating the senior debt in an active group company, with available assets, and directing the junior debt to the parent company.

Priority of shareholders

In the event of insolvency, these arrangements will remain effective subject to the mandatory pari passu principle that the priority of creditors on insolvency is determined by whether they are preferential, general or deferred creditors.

Care must be given in the drafting of such arrangements so that they do not run the risk of being considered ineffective if caught by the fraudulent preference provisions of the Companies Law.

Where the same security is provided to different classes of creditors, inter-creditor arrangements are also made between the lenders and the borrower company through an inter-creditor agreement that sets out the terms and conditions of their relationship.

5.8 Priming Liens

The most common tools used by lenders to secure their interests arise by operation of Cyprus law that can prime a lender's security interest, and typically include the following.

- Mortgage – a lender can establish a mortgage over immovable property, which provides it with a priority claim over the property in case of default.
- Pledge – a lender can secure its interest by taking a pledge over movable property, allowing it to have a priority claim over those assets.
- Floating charge – this allows a lender to secure its interest over a class of assets, which can change over time until an event of default occurs.

- Fixed charge – a lender can take a fixed charge over specific assets, ensuring their priority claim over those assets throughout the loan's duration.
- Lien – is frequently taken over items that are being transported, and might be a common law legal lien or an equitable lien. The lien grants the holder simply the right to keep the debtor's property until payment is made and does not include a right to sell. The carrier's lien (the right to maintain custody of the goods) is subsequently discharged upon payment of the transportation fees.
- Guarantee – personal guarantees from third parties can be used to secure a lender's interest and provide an additional layer of protection. Companies also commonly provide guarantees as security for money owed by itself or a third party.
- Shareholding or management participation – is less common, but saw increased use post-2013, especially with non-performing clients as part of a restructuring, whereby a lender would take a shareholding or management interest or position (or both) in the underlying asset. This would normally by coupled with exit and sale provisions.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Generally, a secured lender will be in a position to enforce its collateral in the event that the borrower (and/or any other party providing securities for the loan facility arrangement) is in default of their obligations, as will be more specifically set out in the loan facility or security documents.

In the event of a charge and pledge over shares and share certificates, the pledge agreement secures – through pre-delivered title documents – enforcement under specified circumstances without the need for court recourse.

In the event of a floating charge, on a default event, the charge will become fixed and crystallise over the secured assets in accordance with the terms of the agreement, enabling the secured lender (or its administrator/receiver) to liquidate the securities in settlement of the amounts due to it. It is noted that in the event of the security provider undergoing a winding up procedure, in general, secured creditors by way of a fixed charge are entitled to enforce their security in settlement of their particular debt which the security provider has failed to pay, in accordance with the enforcement terms of the agreement or the document creating the charge. Floating charges, if not crystallised prior to the commencement of the liquidation or subject to the security documentation, rank for payment after liquidation costs and preferential payments, and before other unsecured creditors.

6.2 Foreign Law and Jurisdiction

The Rome I Regulation (EC) No 593/2008 applies in Cyprus and sets out EU-wide rules for deciding the governing law to be applied to contracts in civil and commercial matters, when parties from more than one country are involved, regardless of domicile (Regulation (EU) No 1215/2012 ("Brussels Recast")). The parties to a contract are free to choose the governing law, and the applicable law can be amended, as long as all parties consent to it. Therefore, a choice of foreign law as the governing law of a contract in a security contract shall be recognised as long as it is made without duress and is not contrary to public policies of the Republic of Cyprus. However, when security is taken over immovable property in Cyprus, as well as a pledge of shares

in a Cypriot company, domestic law will inevitably apply in order to be valid and enforceable.

Jurisdiction matters are administered by the Brussels Recast, which applies again only to civil and commercial matters. The only reason for a judgment passed in an EU member state not to be accepted, is its recognition being challenged, and for that reason, an assertion that such foreign judgment is enforceable is issued once the official and proper review of the related documents has been made.

Applicable and Foreign Jurisdictions

The applicable jurisdiction is usually the one where a defendant is domiciled, irrespective of nationality, and domicile is governed by that member state's law where a matter is brought before its court.

Submission to a foreign jurisdiction would be upheld as long as the jurisdiction clause had been agreed between the contracting parties themselves and specified in the contract. Appearing in the proceedings or serving a defence would also be grounds for submission to a foreign jurisdiction. If a defendant does not want to submit to a specific jurisdiction, the defendant must not contest the case on its merits, they should acknowledge service stating that they intend to dispute the jurisdiction and make a declaration that the specific member state lacks jurisdiction.

The Cypriot courts do acknowledge and uphold state immunity, as long as such immunity is not consensually waived and a state is not acting in a private or commercial capacity.

6.3 Foreign Court Judgments

Depending on the country of the foreign court, it is possible for a foreign judgment or arbitral award to be recognised and enforced in the Republic of Cyprus. In order for a judgment to be valid in Cyprus, it must go through the Cypriot courts' registration system, in order to acquire the same status as a judgment from a national court.

Cyprus is party to various multilateral and bilateral international conventions with other countries, which is influential to the recognition and enforcement of foreign judgments. Different procedural mechanisms may be used to recognise and enforce a foreign judgment depending on the nationality of the court issuing the judgment or arbitral award. For example, Cyprus is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958) (the "NY Convention") and although a judgment from New York would be recognised under the Recognition, Enforcement and Execution of Foreign Judgements Law 121(I)/2000, enforcement is not immediate. The law provides procedural requirements to be followed and ultimately sets a hearing where the respondent can object to matters concerning jurisdiction and substance.

When judgments or arbitral awards derive from an EU court, they will be recognised and enforced accordingly with the Brussels Regulation and the recognition under national law will be automatic. A judgment given by another EU member state court can be challenged in respect of its recognition under specific circumstances by the domestic courts, whereas it cannot be challenged in terms of substance. Therefore, Cypriot courts are not in a position to review the substance and/or merits of a judgment.

6.4 A Foreign Lender's Ability to Enforce Its Rights

Aside from contractual restrictions specified in the security/loan agreements or specific debtor

protection provisions (such as lending to homeowners for first homes), bankruptcy/insolvency may have an impact, as may any court proceedings initiated by other creditors.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

The degree to which a lender's rights of enforcement are affected upon the commencement of insolvency proceedings depends on the kind of security the lender has over the assets of the insolvent entity. Where relevant, a contract can set out insolvency as an event of default whereby termination and enforcement procedures can be triggered as set out in the contract.

If a winding-up order is made or a provisional liquidator has been selected, the (provisional) liquidator takes over all assets and things in action to which the company is or seems to be eligible.

A secured creditor ought to file with the official receiver, liquidator or guarantor, a preparatory valuation of the secured asset and reach agreement about the valuation. An independent valuer may be appointed if no agreement is reached regarding the value. The court may also impose a deadline by which all lenders must verify any debts or claims they may have. If the creditors' debts are not evidenced, then they will be omitted from any distribution since the proof will set out whether the creditor is a secured or unsecured creditor.

Any distribution of the company's property, which occurs after the beginning of winding-up by the court, is void, unless the court orders otherwise. Once a winding-up order is issued by the court and a provisional liquidator is selected, no further action or proceeding can be continued or commenced against the company, unless by leave of the court.

7.2 Waterfall of Payments

The priority ranking of creditors' claims is determined by law and is as follows:

- the costs of the winding-up;
- preferential debts, ranking equally, which comprise:
  - (a) all government and local taxes and duties due at the date of liquidation and having become due and payable within 12 months before that date and, in the case of assessed taxes, not exceeding one year's assessment; and
  - (b) all sums due to employees including wages, up to one year's accrued holiday pay, deductions from wages (such as provident fund contributions) and compensation for injury (claims of employees who are shareholders or directors may not rank as preferential depending on the nature of the shareholding or directorship);
- secured creditors;
- unsecured creditors;
- sums due to members in respect of dividends declared but not paid; and
- any share capital of the company.

Before payments may be made to creditors with a lower priority ranking, claims in that ranking must be fully fulfilled. If the assets of the firm are inadequate to satisfy all creditors of a particular ranking, payments to such creditors are made on a pro rata basis.

7.3 Length of Insolvency Process and Recoveries

The duration of typical insolvency processes in Cyprus can vary depending on the complexity

of the case, the size of the company, and other relevant factors. Generally, insolvency proceedings in Cyprus could take anywhere from several months to a few years to complete.

Secured creditors and preferential creditors usually have a higher likelihood of recoveries closer to the value of their claims due to their priority in the repayment order. On the other hand, unsecured creditors might receive lesser amounts or nothing if the company's assets are insufficient to cover all its debts.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Corporate reorganisations can take place according to the Companies Law, by way of compromises or arrangements, usually suggested between the company and either its creditors and/or its shareholders. A court application is therefore made either by the company, or any creditor or a shareholder, seeking a court order for a creditors' or shareholders' meeting subject to the voting requirements being met. The compromise or arrangement becomes binding to all persons involved, when the court approves the court order requested.

The examinership concept is aimed at a company when facing possible insolvency, as an attempt to prevent liquidation. With this, the intention is to appoint an examiner, whose duty will be to assess the rescue plan, while the company is placed under the court's protection, and if the rescue plan accompanying the petition is considered viable, then the court will permit the commencement of "rescuing" the company.

In order for the court to appoint an examiner, three conditions must be met:

- the company is, or most likely will be unable to pay its debts;
- no liquidation resolution for the company has been published in the Official Gazette of the Republic of Cyprus; and
- no court order has been issued for the liquidation of the company.

Furthermore, if the court is convinced that there is a plausible chance of the company enduring, with its entire or part of its business as a going concern, then it will issue an order for examinership. During that time, the company is "protected" and no court action can be taken against the company without specific court sanction.

7.5 Risk Areas for Lenders

Once a company goes into liquidation, any activity relating to property such as mortgage, charge, payments and so forth made up to six months prior to the commencement of the winding-up, could be considered as "fraudulent preference" and ultimately be set aside. This occurs when a creditor is given undue advantage over others and ends up having a better position than they would have, at a time when the company is not able to pay its debts. If found guilty, such creditors ought to pay back any benefit they obtained.

Where a transaction falls within the definition of a "financial collateral arrangement" under the Financial Collateral Arrangements Law, 43(I)/2004 (the "FCA Law"), such an arrangement is not automatically void based on the fact that a financial collateral agreement has been entered into or has been provided, within the timeframe of six months prior to the commencement of winding-up. If, however, such a transaction is considered to be a fraudulent preference of its creditors then it can still be set aside and in such a case the FCA Law should be interpreted on the basis of a bona fide person with no prior

knowledge of any fraudulent dealings to defraud any creditors.

Furthermore, a floating charge created within 12 months of a company commencing wind-up procedures and which is currently in liquidation, will be void unless it is proved that the company was solvent after the creation of the said charge. If a charge is not registered as per the requirements, the charge will be void against the liquidator and any creditor, but its validity will not have any interference with the chargor and the chargee.

8. Project Finance

8.1 Recent Project Finance Activity

Cyprus is a popular project finance location due to its favourable business climate and array of incentives for both domestic and foreign investors. Thus, once a project is located in Cyprus then it can be (and often is) financed via local institutions or institutions that have a local presence. The vast majority of lenders in Cyprus are credit and finance institutions that have been lawfully authorised by the Central Bank of Cyprus to conduct such credit activity.

The main recipients of project financing are infrastructure development, energy (particularly renewable energy projects), real estate and transportation.

8.2 Public-Private Partnership Transactions

Public-private partnership (PPP) transactions in Cyprus are constant. There is no finance specific PPP-enabling legislation currently in force but general public procurement laws and regulations, as well as specific legislation, apply depending on the field of operations.

Both international airports of the Republic of Cyprus are managed by an operator with a BOT concession. The operator is an international consortium, containing various local and international partners such as dominant French construction groups and international airport operators.

Undisputedly, PPP is crucial and of major significance to the Cypriot economy, something that has been demonstrated by the Cyprus National Reform Programme of the Presidency's Unit for Administrative Reform, that mentioned that a certain PPP unit will be set up within the Public Works Department. Finally, since Cyprus is a member of the EU and stands in line with EU laws and regulations, it is deemed a free-market economy and there are thus practically no legal restrictions in contracting out certain services or utilities to private entities.

Current PPP Projects

The upcoming integrated casino resort "City of Dreams Mediterranean" in Limassol, one of the biggest casino projects in Europe, is again a consortium of international investors (Melco International) and local investors.

The discovery of natural gas around and in the vicinity of Cyprus has attracted the attention of multinational companies like Total, Exxon Mobil, Kogas, Qatar Petroleum and Eni which have started works for the extraction of the gas and to exploit potential oil deposits. Recent financing relates to the creation of an oil terminal and hydrocarbon-related infrastructure.

Requirements for PPP Projects

The Law on Fiscal Responsibility and Public Finances Framework of 2014 (Law 20(I)/2014) sets out the minimum public sector requirements when dealing with and handling PPP projects.

The Law outlines what a "significant project" actually is (in cases where PPP is applicable), the assessment principles and other applicable specifications and tests that ought to be conducted by the public sector when assessing PPP offers.

In addition, The Law on Public Procurement 73(I)/2016 (as amended) is the primary law on public procurement contracts in Cyprus. It effectively integrates the EU Procurement Directives 17/2004 and 18/2004 into domestic law, and handles the co-ordination of procedures for the award of public works contracts, public supply contracts, public service contracts and related matters.

8.3 Governing Law

The choice of law and dispute resolution mechanism for project documents can vary depending on the parties involved (including financing parties) and their preferences. Cyprus law allows parties to choose the governing law and jurisdiction of their contracts, making it possible to opt for laws other than Cypriot law and alternative dispute resolution methods. However, agreements on projects located in Cyprus will commonly be governed by local law.

It is permissible for international commercial contracts in Cyprus, especially those involving foreign parties, to use English law as the governing law. Additionally, international arbitration is often favoured as the dispute resolution mechanism, providing a neutral and efficient means to settle conflicts between parties.

8.4 Foreign Ownership

There are no general restrictions on EU nationals owning real property in Cyprus. There are, however, some restrictions for non-EU nationals or companies.

A non-EU citizen or a company controlled by a non-EU citizen, foreign company or trust, the beneficiary of which is a non-EU citizen, cannot acquire real estate in Cyprus without prior permission from the Cypriot Council of Ministers (these powers are now vested in the relevant District Officers) under the Acquisition of Immovable Property (Aliens) Law, Chapter 109.

Regarding foreign lenders holding or exercising remedial rights on liens on real property, Cyprus generally does not impose restrictions on the security. Foreign lenders will be subject to the same laws and regulations as domestic lenders when it comes to providing loans secured by real property, subject to the above restrictions on ownership and need to comply with local legislation once the security is exercised.

8.5 Structuring Deals

When structuring a project finance deal, aside from the commercial elements, the key legal issues to consider include:

- asset ownership and corporate risks;
- authority/capacity of the counterparty to enter into the transaction;
- governmental or other authorisations or permits;
- financing structure; and
- security and collateral.

In terms of legal form, project vehicles are likely to take the form of a limited liability entity potentially coupled with either a shareholders' agreement or a partnership at ownership level to allow for increased flexibility and discretion on decision-making.

Local rules and legislation may have an impact on the overall structuring beyond the customary employment, health and safety legislation (eg,

the Safety and Health at Work Law of 1996 (Law 89(I)/1996)) such as the hydrocarbon exploration and exploitation activities in the Republic of Cyprus are governed by the Hydrocarbon (Prospection, Exploration and Exploitation) Law of 2007 (No 4(I)/2007) and the Hydrocarbon (Prospection, Exploration and Exploitation) Regulations of 2007 and 2009 (No 51/2007 and No 113/2009).

Finally, in view of the ESG drive, relevant factors should also be considered, especially for projects in the energy sector.

8.6 Common Financing Sources and Typical Structures

Most project finance in Cyprus takes the form of either equity (capital) finance or bank finance (or combination of both). A few examples of export credit agency financings are the following.

- Bank financing – traditional bank loans or credit lines are one of the most common sources of project financing. Banks may provide loans directly to the project company or participate in syndicated loans with other financial institutions.
- Private equity (capital) funding – private equity (either own or from third parties) provides equity capital to the project in exchange for ownership stakes.
- Export credit agency (ECA) finance – refers to transactions in which representatives of specific nations grant financial assistance to the export of qualifying capital goods and related services from their home jurisdiction. ECA finance is a type of trade credit that benefits both exporters and foreign purchasers.

The following may be used, but this is seldom the case in Cyprus.

- Project bonds – project bonds are debt securities issued by the project company to raise funds for the project. Institutional investors can engage in infrastructure projects using project bonds, as they are listed, tradable instruments that can provide higher risk-adjusted returns.
- Alternative sources of financing:
  (a) streaming or royalty financing – is a type of alternative financing arrangement commonly used in the mining and natural resources industries. In this financing model, a company provides upfront capital to a mining or resource-extraction project in exchange for the right to receive a portion of the project's future production or revenue; and
  (b) commodity trader financing – is a subset of commodity finance that refers to the financing of the underlying commodity exchange from supplier to buyer and is linked to the asset conversion cycle.

8.7 Natural Resources

Different legislation is set in place for each type of natural resource existing in Cyprus and depending on the industry of the project, various and/or different licences may be required prior to commencing any actual work.

Traditionally, mining activities were dominant in Cyprus and a licence to carry out such activities would be required by the Mining Service of Cyprus, for any exploration and exploitation of minerals as per the Mines and Quarries Law Chapter 270 (as amended). A more recent example is the discovery of hydrocarbons in the region of Cyprus, which prompted the Hydrocarbon (Prospection, Exploration and Exploitation) Laws of 2007 to 2019. The EU Directive has been incorporated into Cypriot law, specifying the conditions for approving and authorising

the prospection, exploration and production of hydrocarbons. Any successful licensee will be required to enter into an Exploration and Production Sharing Contract (EPSC), with the Ministry of Energy, Commerce, Industry and Tourism, as the relevant authority and ultimately share their revenues with the Republic of Cyprus.

The EPSC obliges the contractor to comply with the applicable tax laws and regulations of Cyprus and the EU, as a 5% withholding tax on gross income derived from within Cyprus is charged. However, in contrast, no exact tax regime is applicable in relation to oil and gas companies operating in Cyprus.

Furthermore, any grade-scale construction projects such as the construction of marinas, golf courses and/or hotel resorts, will require an assessment of the building procedures and environmental impact, as they may have a harmful impact on the environment. In such cases, the Town and Country Planning Law 90/1972 (as amended) and the more recent Law on the Estimation of Repercussions on the Environment for Specific Construction Work, specify the requirements for the issuing of certain licences related to town planning and restrictions on foreign entities which are eligible to apply for such licences.

8.8 Environmental, Health and Safety Laws

There is no legislation specific to project financing. However, aside from general legislation such as the Safety and Health at Work Laws (89(I)/1996 as amended), depending on the specific industry there may be further regulations regarding the operations and safety requirements specific to that sector – eg, in order to protect the worker and the environment in natural resource projects, the Safety and Health at Work (Safety of Offshore Oil and Gas Operations) Regulations of 2015 (P.I. 424/2015) have been introduced under the Safety and Health at Work Laws of 1996 to (No 2) of 2015 (the "Regulations"). The Regulations lay down minimum requirements for the prevention of major accidents during offshore oil and gas operations and the mitigation of the consequences of such accidents.

In addition, the Law on Environmental Liability with regard to the Prevention and Remedying of Environmental Damage No 189(I) of 2007 (as amended) renders any natural or legal, private or public person who operates or controls the occupational activity or to whom decisive economic power over the technical functioning of such an activity has been delegated by law, (including the holder of a permit or authorisation for such an activity or the person registering or notifying such an activity) liable for environmental damage caused. According to the law, strict liability is imposed upon the operator, for charges of prevention and remediation of environmental damage caused by any of its registered "occupational activities". This incorporates "any activity carried out in the course of an economic activity or an undertaking, irrespectively of its private or public, profit or non-profit character".

The competent authority for Cyprus is the Environmental Authority of the Ministry for Agriculture, Natural Resources and Environment. A lender financing a project or a guarantor providing security for a project, is not liable under environmental legislation unless it is deemed to be an operator.

EGYPT

Law and Practice

Contributed by:
Ashraf Hendi, Mariam Hesham and Habiba Gamaleldin
Matouk Bassiouny & Hennawy

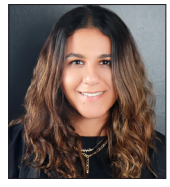
Contents

Matouk Bassiouny & Hennawy was established in 2005 and has since developed into a premier full-service business law firm in Egypt and the MENA region, with offices in Algeria, Sudan, and the UAE, as well as two country desks covering its Libya and South Korea practices. Its over 200 lawyers are trained locally and internationally in common and civil law systems and are fully conversant in English, Arabic, French and Korean. The firm's finance and projects group – headed by regional managing partner and group head of finance and projects Mahmoud S Bassiouny – represents numerous clients in the energy sector, focusing on areas such as renewable energy, oil and gas, power (including nuclear power), gas pipelines, and transmission and distribution assets.

Authors

Ashraf Hendi is a partner in Matouk Bassiouny & Hennawy's finance and projects practice group. He has particular expertise in financing transactions and has represented clients in several syndicated and bilateral facilities, project finance and equity finance transactions. Ashraf's expertise brings together the legal and practical know-how gained from representing several financial institutions and corporations in a variety of sectors. He has worked on several banking and finance transactions in the GCC market and represented several international financial institutions in multi-jurisdictional debt finance transactions and Islamic financing. Ashraf has also worked on many structured finance and securitisation transactions.

Mariam Hesham is a junior associate at Matouk Bassiouny & Hennawy, and a finance and projects practice group member. Mariam's practice focuses on energy and project finance matters, where she has participated in various cases of due diligence and reviewed numerous agreements and transactional documents.



Habiba Gamaleldin is a junior associate at Matouk Bassiouny & Hennawy, and a finance and projects practice group member. Habiba's practice focuses on drafting and negotiation of facility agreements, finance and security documents and term sheets. She has worked on several sectors, specifically the banking, energy, and power sectors.

Matouk Bassiouny & Hennawy

12 Mohamed Ali Genah
Garden City
Cairo
Egypt

Tel: +202 2796 2042
Fax: +202 2795 4221
Email: info@matoukbassiouny.com
Web: www.matoukbassiouny.com

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

The banking laws and regulations in Egypt have been subject to continuous amendments and updates throughout the past decade. The Banking Law No 194 of 2020 (the "Banking Law"), which was issued on 15 September 2020, expanded upon the previous banking legislation, the Central Bank Law of 2003. The Banking Law determines many unclear and unsettled matters from the previous legal regime and embraces new financial technologies within the regulatory system. This has helped the banking sector reach out to unbanked businesses, including for services such as lending and cash management activities.

The legislature has also expanded on other corporate financing alternatives – such as through the recent issuance of the Microfinance Law, the Consumer Finance Law and the Factoring and Financial Leasing Law – in addition to the many other initiatives of the Central Bank of Egypt (CBE) in relation to companies operating in the tourism sector and the financing of mid-level residential units. This is in addition to transactions of issuing bonds and securitisations that have started to attract the interest of new business sectors.

These types of financing have created different structures for lenders and alleviated the pressure on the banking sector in certain areas. They have also created competing financiers that can offer alternative corporate finance solutions to traditional banking products. In relation to the loan market in Egypt, the real estate sector remains a huge player, with a lot of greenfield projects and restructuring deals resulting from the economic impact of the COVID-19 pandemic.

1.2 Impact of the Ukraine War

The Russia-Ukraine war has added tension to the Egyptian economy and caused inflation to soar, multiplying the effects of COVID-19 on the economy. As Egypt relies heavily on Ukraine for agricultural commodities, there was a deficit in these and this was reflected in a price hike for many products and commodities. To alleviate such economic turmoil, the CBE's Monetary Policy Committee (MPC) convened on 21 March 2022, amid the Ukraine war, to answer the ongoing threats. The MPC has set the inflation target at 7% on average by the fourth quarter of 2024 and has raised policy rates by 100 basis points. Further, the MPC released a statement on

2 February 2023 confirming that it has increased the required reserve ratio by 400 basis points in September 2022. Generally, the MPC reiterates that monetary policy tools are utilised to anchor inflation expectations and contain demand pressures and has depreciated the Egyptian pound against the US dollar.

The increased cost of finance caused the CBE to renew its initiatives for many of the troubled sectors that are crucial to the economy. For example, several initiatives were introduced and reintroduced for the real estate, agricultural, and tourism sectors to support distressed and struggling businesses in these sectors.

1.3 The High-Yield Market

Egyptian banks operate under regulations from the CBE to manage any default risk and undertake ongoing measures to screen the creditworthiness and financial health of borrowers. This has limited the high-yield market to foreign non-institutional lenders and other alternative forms of trade financing offered by foreign traders. Thus, the high-yield market operates under different conditions that do not interact with mainstream institutional lending, whether through Egyptian or foreign institutions.

The recent inclination towards securitisation did not affect the loan market in a significant way, as this relates to businesses that operate in quite specific sectors, such as capital markets activities. The securitisation transactions also operate under legal and regulatory requirements that set out minimum rating requirements for the assigned rights and the issued bonds.

1.4 Alternative Credit Providers

The loan market has recently seen an increased reliance on international financial institutions and multilateral development agencies compared to previous decades and macroeconomic projects. These institutions are taking a bigger role in the local loan market as they offer convenient solutions that have a competitive edge over Egyptian commercial banks. Foreign commercial banks have also followed suit in financing infrastructure mega-projects in several transactions according to syndicated loan structures.

Such lending transactions are, by convention, based on English law or the laws of the State of New York. Foreign commercial banks usually rely on the documentation of the Loan Market Association, while each international financial institution relies mostly on its own standard set of loan documentation. The reliance on standard documents is an advantage because it streamlines the loan documentation process; nonetheless, the application of foreign law on lending transactions in Egypt has proved to be a burden on transaction costs in several instances.

Additionally, recent trends have seen companies increasingly resorting to alternative financing methods such as factoring, financial lease and other non-banking financial solutions. These activities provide alternative forms of credit, subject to obtaining the required licences by the Financial Regulatory Authority (FRA), and operate under different pieces of legislation, such as the Financial Leasing and Factoring Law No 176 of 2018. Most recently, Egypt issued Law No 5 of 2022 regulating and developing the use of financial technology in non-banking financial activities for the regulation of fintech financial activities. Many of the companies operating in these activities

1.5 Banking and Finance Techniques

There are certain techniques that firms and commercial banks are currently relying on to mitigate the risk of their portfolios. Against the backdrop

of highly leveraged corporations and sovereign debt borrowers, a hedging arrangement or a sovereign guarantee often provides a safe harbour against potential risk, which is typically governed by International Swaps and Derivatives Association (ISDA) Master Agreements. There are also several mega-project transactions that involved the participation of an insurance agency to mitigate any default risk.

In addition, borrowers are concerned about the interest rate risks and the volatility of interest rates. This has led to an increased reliance on selection notices to have the option to choose between variable and fixed interest rates at certain points throughout the lifetime of the loan.

1.6 ESG/Sustainability-Linked Lending

The FRA has issued regulations requiring companies to prepare disclosure reports on ESG standards after approving the first issuance of green bonds in the Egyptian capital market – worth USD100 million – to a company listed on the Egyptian Exchange (EGX). Companies listed on the EGX and companies with non-banking financial activities have to provide ESG disclosure reports related to sustainability.

In addition, other reports related to the financial consequences of climate change shall also be provided by such companies. As of January 2022, a quarterly statement on the procedures taken, or that will be taken, by companies with respect to such disclosures shall be also provided to the FRA.

2. Authorisation

2.1 Providing Financing to a Company

Commercial lending activities in Egypt are subject primarily to the Banking Law, which defines a banking activity that would require a licence from the CBE as any service provided customarily by banks in Egypt on a recurring basis. For a bank to operate in Egypt, it must have a licence from the CBE and comply with all the regulations of the CBE.

Other non-banking financial services are regulated under the Capital Market Law No 95 of 1992, as amended, and are regulated by the FRA. This includes types of financing such as factoring, invoice discounting, securitisation, margin trading and investment banking. Moreover, according to the Microfinance Law No 141 of 2014 as amended, companies that are licensed by the FRA can provide microfinancing to businesses with a ceiling of up to EGP200,000 for each loan.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

The Banking Law defines banking activities as those that involve, on a primary and recurring basis, receiving deposits or obtaining funds, investing those monies to grant financing or credit facilities, participating in the capital of companies, and undertaking what is considered as banking activity by reference to the prevailing customs. These are the main activities of commercial banks in Egypt and would require the entity that practises these activities to have a licence from the CBE. Additionally, pursuant to Article 1 of the Banking Law, entities and branches of foreign banks may undertake banking activities provided that the relevant CBE licence is obtained. The Banking Law includes an explicit restriction on any entity not licensed to practise such activities.

This restriction, although broad and explicit, is faced with the reality that many foreign commercial banks provide loans to companies in Egypt, including governmental and public entities, on a non-recurring basis. It is also common practice to have intra-group and shareholders' loans without considering such transactions caught by the Banking Law restriction.

These practices have led to a development in the construction of the rule regarding the Banking Law restriction, so that the acceptable interpretation is deemed to catch lending activities by an entity which are recurring, continuous, and offered on a non-solicited basis to potential borrowers in Egypt. The settled position, then, is that competent authorities close their eyes to foreign lenders providing loans to Egyptian entities as long as such lending is not advertised or offered to the public and is not considered a significant part of the lending activities of the foreign lender.

3.2 Restrictions on Foreign Lenders Receiving Security

The regulatory framework around granting securities to foreign lenders may vary according to the type of collateral involved. For example, Article 106 of the Banking Law gave foreign banks and foreign financial institutions the right to take real estate mortgages and commercial mortgages. This can be practically achieved through a prior authorisation from the CBE.

Limitations Relevant to the Movable Collaterals Law

In relation to the Movable Collaterals Law No 15 of 2015 (the "Movable Collaterals Law"), which regulates the granting of securities such as pledges over bank accounts, future assets, and movable assets, including intangible assets, the law requires the entity benefiting from the security to be licensed as an Egyptian bank, a financial leasing company, or another type Egyptian company licensed to provide credit solutions. This means that the Egyptian Collaterals Registry is limited to Egyptian entities, which have exclusively online access to the Registry.

Limitations Relevant to Security on Immovable Security

In relation to real estate mortgages, Egyptian law does not include any general restriction on a foreign lender being a mortgagee under a mortgage contract. However, there is a disparity between the legal rule and its application. The offices of the Notary Public in Egypt, being the competent authority responsible for real estate mortgage registration, do not, as a matter of practice, accept any mortgage registration with a foreign entity as a beneficiary. It is yet to be clarified whether such practice is based on internal regulations or merely common practice developed over the years.

Limitations Relevant to a Shares Pledge

A pledge on shares in a joint stock company is executed in the form of an agreement that has to be registered with Misr for Central Clearing, Depository and Registry (MCDR), the authority responsible for the central depository of all shares in joint stock companies, in order to block any trading on the shares in the registers of the MCDR. One of the requirements for the MCDR to register such a pledge, is that the pledgee must be coded on the EGX to be able to sell the shares in an enforcement scenario. This coding system on the EGX is available for foreign as well as Egyptian entities and individuals.

3.3 Restrictions and Controls on Foreign Currency Exchange

At present, there are no specific restrictions, controls, or other concerns regarding foreign

currency exchange, which is permitted through banks registered with the CBE and licensed foreign exchange bureaus. The Banking Law also includes several provisions that provide for the licensing of foreign currency exchange firms, and payment facilitators and payment aggregators, although these provisions leave the details of the licensing processes to be decided by the board of directors of the CBE.

3.4 Restrictions on the Borrower's Use of Proceeds

According to the Banking Law, the borrower must use the loan proceeds for the purposes contained in the credit approval of the bank and the bank must supervise such use. The use of the facility proceeds is subject to the general principles of Egyptian law regarding corruption, terrorism and money laundering. The use by the borrower of the loan proceeds for any of the aforementioned purposes would be penalised under the relevant criminal provisions. Furthermore, the use of the loan proceeds for a purpose other than the purpose included in the credit approval is subject to imprisonment and/or a fine not exceeding EGP1 million and not less than EGP100,000.

In Islamic finance transactions, the general rules of Sharia apply and, as such, the proceeds cannot be use in activities such as gambling, or those relating to alcohol or arms trading.

3.5 Agent and Trust Concepts

The concept of a trust is not specifically recognised under Egyptian law, although its general features can be found in the agency rules, with certain disparities. It is common in syndicated loans to have security and facility agents play an administrative role representing the interests of the syndicate lenders.

The facility agent can be appointed in the same debt instrument to act on behalf of the lenders in relation to the management of documentation and transfer of funds to and from the borrower. The security agent holds the security documents on behalf of the lenders, and in cases of default, it is entitled to initiate enforcement procedures on behalf of the lenders.

Typically, a loan agreement includes an obligation on the borrower to pay annual fees to the agents, in consideration for the services performed by them. The agency roles as clarified can be based on the agency provisions included in the Civil and Commercial Codes.

3.6 Loan Transfer Mechanisms

The transfer of a loan between lenders can be made by way of an assignment that is subject to the Egyptian Civil Code (ECC). The assignment agreement is executed between the existing lender and the new lender without the necessity of having the borrower as a party. The notification to the borrower, however, is required to make the assignment effective towards the borrower as per Article 305 of the ECC. Also, in practice, the existing lender and the new lender sign an assignment certificate whereby the assignor bank is exempted from its obligations under the loan agreement.

Security interests can also be transferred by way of an ECC assignment from a theoretical perspective. However, it is recommended in many cases to cancel the security interest and create a new security interest in favour of the new lender. This is especially relevant in cases where the existing security interest does not include all favourable terms for the new lender or where there are practical considerations that impede the transfer of security process.

3.7 Debt Buy-Back

There are no specific restrictions on debt buy-back by the borrower or sponsor.

3.8 Public Acquisition Finance

There are no rules regarding "certain funds" with respect to public acquisition finance transactions. The usual set of documentation is typically used in these transactions. All information on loans and other financings taken by the bidder must be disclosed in its subscription bulletin.

3.9 Recent Legal and Commercial Developments

The recent economic turbulence caused by COVID-19 followed by the Russia-Ukraine war have caused parties in the loan market to stress the importance of having well drafted market disruption clauses. Also, many US dollar-denominated loan agreements have recently been subject to addendums for adopting the transition from the London Interbank Offered Rate (LIBOR) to the Secured Overnight Financing Rate (SOFR) as a reference for interest rates.

3.10 Usury Laws

Under the ECC, to the extent that interest payable by an Egyptian entity would exceed 7% per annum, including compounding or capitalisation of interest, or interest exceeding the principal, such excess is unenforceable.

It may be argued that the calculation and determination of interest is subject to Article 50 of the Commercial Code, which allows such rate between merchants to a contractual maximum of the rate declared by the CBE from time to time. This restriction does not apply to banks licensed and registered in Egypt to undertake banking activities, which banks are entrusted to freely set interest rates subject to the nature of the banking activities in accordance with the Banking Law.

3.11 Disclosure Requirements

The are no specific requirements to disclose financial contracts other than the generally applicable regulatory reporting and disclosure requirements for the activities of financial institutions in general. Egyptian banks and financial institutions are also subject to contractual obligations with the US authorities to disclose information relevant to US individuals and entities under Foreign Account Tax Compliance Act (FATCA) rules. Many of these institutions request specific clauses in the documentation to allow them to disclose such information.

4. Tax

4.1 Withholding Tax

Interest payments paid overseas to entities that are non-resident in Egypt by entities which are resident or have a permanent establishment in Egypt are subject to withholding tax at a rate of 20%, whether paid directly or indirectly, without any deductions, and subject to any double taxation treaty which may provide for a lower withholding tax rate or an exemption from tax. Withholding tax must be remitted to the Tax Authority on the first business day following the day on which the withholding has been deducted.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Pursuant to the Egyptian Stamp Duty Law No 111 of 1980, a stamp duty tax is levied in respect of credit facilities and loans extended by banks. The rate of the stamp duty tax is ten basis points every quarter calculated on the highest debt balance throughout the quarter under the facility, loan or borrowing extended by the bank. The

stamp duty tax must be borne and split equally between the lender and the borrower and should be transferred by the lender to the competent tax authority within a maximum period of seven days from the end of each quarter.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Loans extended by foreign lenders or non-money centre banks remain subject to a withholding tax on interest rates in accordance with the Income Tax Law. This is usually mitigated through including tax gross-up clauses in the loan agreement to shift the burden of tax to the borrower.

5. Guarantees and Security

5.1 Assets and Forms of Security

Egyptian law recognises various forms of security over assets including real estate mortgages, tangible and intangible movables mortgages, pledges of bank accounts, pledges of shares, security on claims and receivables such as accounts receivable and rights under contracts. The security takes the form of an agreement between the pledgor and the pledgee.

Perfection of the security will vary subject to the nature of the same. In order to perfect a real estate mortgage, it shall be notarised with the Notary Public, while perfection of a possessory mortgage entails transferring the possession of the movables, subject of the mortgage, to the pledgee in order for the pledge to take effect. The Egyptian Collaterals Registry has been established to register security interest over movable assets, including cash deposited in bank accounts and non-possessory pledges. In the case of a share pledge, the relevant security interest must be registered with the MCDR. Unregistered security interests would carry the risk of unenforceability towards third parties.

The fees for registering securities will vary according to the type of the security and, in certain instances, subject to the amount of the loan.

5.2 Floating Charges and/or Similar Security Interests

Floating charges are not explicitly regulated under Egyptian law. However, under the Movable Collaterals Law, a pledge may be granted over future assets and registered with the Egyptian Collaterals Registry. Security interest may also be granted to secure a future debt, an overdraft, or a revolving line of credit.

5.3 Downstream, Upstream and Cross-Stream Guarantees

Corporate guarantees, including downstream and cross-stream, are generally permissible subject to the existence of corporate commercial interest. Upstream guarantees are permitted under the Companies Law to the extent that the borrowing shareholder is not represented on the board of directors of the guarantor. The Companies Law further prohibits any company from guaranteeing the obligations of its board members to prevent the abuse of board member's rights for personal interests. Thus, if any subsidiary is guaranteeing the obligations of its parent company, the parties must ensure that the parent is not represented on the board of the subsidiary during the lifetime of the financing.

5.4 Restrictions on the Target

There is no explicit legal provision restricting the target from granting security in the context of the acquisition of its own shares. In practice, the acquirer grants the shares of the target as security for the financing of its transaction. In this regard, it should be noted that the target may

not provide a guarantee in relation to the liabilities of any of its board members, and hence the acquirer may not be represented on the board of directors of the target.

5.5 Other Restrictions

Generally, no further consents are required. Please refer to **5.1 Assets and Forms of Security**. From a practical perspective, registration of in rem security interests may trigger significant survey fees subject to the nature and size of the land, and as determined on a case-by-case basis. This applies to foreign lending institutions only, as Egyptian banks benefit from a cap on notarial fees under the Banking Law.

Please note, however, that certain restrictions may arise in relation to the registration of the security. By way of example, the property itself must be registered with the Notary Public as a prerequisite for registering the real estate mortgage. This might not be practical as the majority of real estate properties in Egypt are not registered due to the lengthy and costly procedures involved.

5.6 Release of Typical Forms of Security

Security release mechanics vary depending on the type of security, but security interests are typically released upon the instructions of the pledgee following the complete repayment of the debt obligations by the pledgor.

Regarding the pledge of shares, the termination instructions by the pledgee must be notified to the MCDR to release the block placed on the shares. For other forms of registrable securities, the release will also have to be perfected in accordance with instructions from the pledgee to the authority responsible for the registration of the pledge.

5.7 Rules Governing the Priority of Competing Security Interests

Regarding the priority of competing security interests, certain creditors enjoy a general or specific lien created by virtue of the law over all or part of the assets of the debtor. For example, the law determines a priority ranking of a lien for judicial expenses and tax obligations over any other debts. Other than lien rankings provided by the law, different lenders have the right to secure their debt and subordinate contractually their rights between themselves and/or other creditors, such as in the case of subordinating a shareholder loan to a creditor. If there is no subordination contractually, the rank of each security interest is determined pursuant to its date of registration and perfection, whereby earlier registration takes precedence over later.

Any contractual subordination executed prior to bankruptcy procedures will survive. However, the borrower shall not undertake any action contradicting the restructuring plan (eg, granting securities) prepared in light of its potential bankruptcy that will affect the lenders' interests. Accordingly, the contractual subordination concluded after the restructuring plan may not survive, subject to the discretionary power of the competent court. If the competent court declared the bankruptcy of the borrower, it shall not administer or dispose of its assets and hence the contractual subordination will not survive.

5.8 Priming Liens

Liens ranked as such and mandatorily preferred by virtue of law shall take priority ahead of contractual loan debts. These preferred liens are generally debts related to judicial expenses and tax dues. After satisfaction of rights mandatorily preferred by law, secured creditors shall recover outstanding debts from the assets taken as security according to their degree of prior-

ity. Finally, unsecured creditors will share any remaining enforcement proceedings on a pro rata basis in relation to the total indebtedness of the debtor. If a secured creditor did not collect all its debt from the asset provided as a security, then the creditor must participate with the remaining uncollected sum in a pro rata distribution with other unsecured creditors. Claw-back rights are not explicitly regulated under Egyptian law.

According to Articles 1138, 1139, and 1140 of the ECC, senior debts that have priority over a secured debt created by a contractual relationship, are as follows according to their order of priority:

- The most senior debts are the judicial expenses incurred for the benefit of all creditors for the preservation and sale of the debtor's money. These are the expenses paid for the benefit of all creditors, such as attachment expenses, custodial services expenses, and procedures of enforcement expenses. These expenses can be paid by and accordingly be due for one of the creditors undertaking these procedures on behalf of the other creditors, or the court. The seniority means that these expenses will be collected from any enforcement proceeds resulting from the sale of the mortgaged assets (whether real estate or commercial) prior to any other rights or debts.
- Second are the amounts due to the public treasury, such as taxes, duties, and other rights that are enumerated specifically by virtue of different laws. These dues to the public treasury can be found in tax laws, such as the Income Tax Law or the Real Estate Tax Law. The seniority means that these dues will be collected from the assets which are subject of the tax dues, each in accordance with the law that determines the tax. For example, real estate tax dues may be collected as senior debt from the enforcement proceeds resulting from the sale of the mortgaged real estate assets.
- Third are amounts incurred for the maintenance and restoration of a movable property, such as maintenance expenses for a car or other movables. These amounts are considered senior debts and can be collected from the value of the relevant movable property.

There are other senior debts that can be specific to a real estate property. These are senior debts by virtue of Articles 1147, 1148, and 1149 of the ECC and will have a priority that is subsequent to other senior debts mentioned in Articles 1138, 1139, and 1140. These debts will not have seniority over secured debts created under a contractual obligation unless they are registered prior to the real estate mortgage.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

The enforcement of security under Egyptian law varies depending on the type of security in question. It is generally completed through selling the asset by public auction through courts. Certain laws expressly set forth simpler enforcement procedures, such as the Banking Law in relation to the enforcement of a share pledge registered in favour of Egyptian banks and the Movable Collaterals Law in relation to a pledge over bank accounts. A general overview on enforcing security in Egypt is as follows.

Immovables (ie, Lands and Buildings)

An "execution order" is issued by the competent court upon the request of the creditor and anno-

tated in the competent Notary Public office. The creditor shall notify the debtor of the execution order and grant a period of 30 days to the debtor to make the due payment. If the debt is not paid, the property will be sold in public auction under the supervision of the enforcement judge.

Movables

Regarding the movable properties pledged under a fonds de commerce mortgage, should the debtor not make the payment within the eight days following the notification to the debtor, the creditor may request that a summary judgment is rendered permitting the sale of some or all of the debtor's assets under the fonds de commerce mortgage agreement by way of public auction. However, if the movables are pledged separately (as opposed to by way of a fonds de commerce mortgage), the creditor has the right to request from the competent court the sale of the pledged property in whole or in part following the lapse of five days from the notification to the debtor with the due payment.

Share Pledge

Following serving a notification to the debtor with the due payment, the creditor may enforce its rights over the shares in accordance with the EGX sale and purchase rules, noting that the MCDR requires that the pledgee must be coded on the EGX to be able to sell the shares under an enforcement scenario. However, upon the occurrence of the incident that requires the creditor to enforce its right over the pledged shares and following the lapse of five days from the written notification to the debtor with the due payment, the creditor may proceed with selling or acquiring the pledged shares and deduct its value from the due payment.

It is not permissible to directly acquire any securities or financial instruments unless the pledge agreement stipulates the same; likewise, the method of evaluating the securities or financial instruments for the purpose of enforcement must be stipulated in the agreement. In all cases, it is not permissible to agree to postpone the enforcement of the pledged securities or financial instruments until an administrative decision or a court judgment is issued, an auction is held, or until a certain period of time has elapsed. Also, the bankruptcy or restructuring of the debtor or the creditor shall not result in delaying the enforcement.

Bank Accounts and Cash Deposits

If the creditor is the bank holding the pledged accounts/deposits, a set-off is usually executed between the pledged accounts/deposits and the amounts owed by the debtor; and if the pledged accounts/deposits are owned by another bank, such accounts/deposits may be claimed by the creditor.

6.2 Foreign Law and Jurisdiction

The choice of foreign law as governing law of the contract is valid to the extent it does not contravene Egyptian public policy or public morality. The application of Egyptian law is only mandatorily applicable in contracts relating to a transfer of technology in accordance with the Commercial Law. The submission to a foreign jurisdiction is generally a valid and enforceable choice, subject always to private international law rules. However, it must be noted that foreign law, for evidential purposes, is treated as a matter of fact and must be proven by the concerned party. In certain matters Egyptian law provides for the exclusive jurisdiction of local courts.

Immunity from suit may be waived contractually. However, waiver of immunity from enforcement is subject to a restriction whereby real property and movables owned by the state or public

juridical persons, which are allocated for public interest in fact, or pursuant to a law, regulation, or decree of the competent minister, are considered public monies that are not subject to attachment according to the ECC.

6.3 Foreign Court Judgments

In relation to foreign court judgments, a request for enforcement of a judgment by a foreign court must be filed in Egyptian courts, in order to review that the foreign judgment satisfies the following conditions (without reviewing the merits of the dispute):

- the courts of Egypt are not competent to hear the dispute, and the foreign courts are competent for the matter in accordance with the rules of international private law for the choice of jurisdiction in that country;
- that the parties to the dispute were duly notified and properly represented in the proceedings;
- that the judgment is final and enforceable in accordance with the law of the foreign country;
- that the judgment does not conflict with any prior judgment issued by an Egyptian court in the same case and is not contrary to public policy in Egypt; and
- the country where the court judgment is issued adopts a reciprocal treatment for the judgments of Egyptian courts.

In relation to foreign arbitral awards, Egypt is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the New York Arbitration Convention of 1958. A foreign arbitral award obtained in a state that is a party to the New York Convention should be recognised and enforced by the competent Egyptian court under an exequatur after verifying that:

- the arbitral award does not conflict with prior judgments issued by Egyptian courts on the same subject matter of the dispute;
- the arbitral award is not contrary to public policy in Egypt; and
- the party against whom the arbitral award is rendered has been duly notified.

6.4 A Foreign Lender's Ability to Enforce Its Rights

There are no specific restrictions on a foreign lender's ability to enforce its rights under a loan or security agreement to the extent that the structure of the agreements and perfection requirements comply with the law. Exceptionally, certain rules may apply for the enforcement of a real estate mortgage considering the rules on foreign ownership of land or real estate. This might also depend on the place where the property is located.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

Pursuant to Article 87 (a) of the Bankruptcy Law No 11 of 2018 (the "Bankruptcy Law"), the bankruptcy trustee shall annotate the declaration of bankruptcy in the Egyptian Collateral Registry (ECR) and the competent Notary Public office. Upon the issuance of a judgment declaring the bankruptcy of the debtor, the debtor shall not repay any debt to a creditor unless through the court proceedings. Following the judgment, the interest on unsecured loans shall be suspended, and the interest on secured loans may not be requested unless to the extent of the amounts collected from selling any collateral assets. Payment of the principal shall take priority, followed by the interest due before the issuance of the judgment, then the interest due after the issuance of the judgment.

7.2 Waterfall of Payments

The order of priority for creditors during a company's bankruptcy proceedings is detailed under **5.8 Priming Liens**.

7.3 Length of Insolvency Process and Recoveries

It is not possible to estimate the length of typical insolvency processes and generation of recoveries as such time limit varies depending on the case.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Egyptian Law differentiates between insolvency procedures applied to non-merchant individuals and bankruptcy procedures applied to merchants, including companies. The Bankruptcy Law provides two procedures that mitigate the financial distress of a company and provides a first line of defence ahead of bankruptcy. These proceedings are as set out below.

Restructuring/Reorganisation

The purpose of restructuring is to figure out a plan to organise and overcome the financial and administrative turbulence of the bankrupt company. Any company may request restructuring provided that its capital is not less than EGP1 million and has conducted business in a continuous manner for the previous two years without committing any fraud. The company may not request restructuring if a judgment has been issued declaring its bankruptcy or opening rescue/reconciliation procedures. The competent judge will approve the plan prepared by the restructuring committee. The company will remain in control of its business, nonetheless the competent judge may appoint an assistant. Pursuant to Article 18 of the Bankruptcy Law, the methods by which restructuring may be achieved include, inter alia, the revaluation of assets, restructuring debts, and capital increase.

Reconciliation/Rescue

Subject to the condition of two years of conducting business, any company that may be declared bankrupt, and that did not commit fraud or gross negligence, has the right to request "a reconciliation from bankruptcy" if there is a disorder in its financial conditions that may lead to cessation of its due payments, or if it has ceased payment (even if a bankruptcy declaration has been requested), has the right to request the reconciliation from bankruptcy and submit it to the competent court. Any debtor company may request a "reconciliation from bankruptcy" upon the approval of the majority of partners or general assembly subject to the type of the company; however, a company subject to liquidation procedures may not request the same. The company under reconciliation will continue managing its own monies under the supervision of a trustee appointed by the competent court. The company can also conclude all kinds of ordinary transactions necessary for its business.

7.5 Risk Areas for Lenders

There is the inherent risk associated with the fact that the monies of the debtor may not be sufficient to pay the debt of all creditors. In that case, the proceeds will be shared on a pro rata basis between creditors unless there are secured creditors.

8. Project Finance

8.1 Recent Project Finance Activity

The main market trends are currently underlined by national financing projects, including infrastructure and real estate, in addition to small and medium-sized projects. The Egyptian Economic

Development Conference (EEDC), held in March 2015, presented investment opportunities to domestic and international investors, and highlighted how well the banking sector weathered the economic turbulence that followed the 2011 revolution.

Additionally, the project finance market in Egypt witnessed:

- the issuance of a new Banking Law (replacing the previous legislation of 2003), which embraces new financial technologies within the regulatory system and expressly permits the creation of security in favour of foreign banks and international financial institutions;
- the inauguration of the ECR created pursuant to the Movables Collateral Law (MCL), which enables security to be created over bank accounts and future assets; and
- the signing of a significant number of sustainable projects in the renewable energy sector, including, green hydrogen projects, the construction of an electric high speed railway, and many solar and wind farms.

8.2 Public-Private Partnership Transactions

Public-private Partnership Overview

Egyptian law recognises public-private partnership (PPP) contracts pursuant to which a project company is entrusted with the financing, construction, equipping and operation of infrastructure projects and public utilities, and making their services available, or financing and rehabilitating such utilities with an obligation to maintain works that have been constructed or rehabilitated and to provide services and facilities necessary to enable the project to produce or provide services regularly and progressively throughout the duration of the contract.

PPPs are primarily regulated under Law No 67 of 2010 regulating partnership with the private sector in infrastructure projects, services, and public utilities (the "PPP Law") and the executive regulations enacted thereunder. PPP contracts must be concluded for a term of no less than five years and up to 30 years from the date of completion of the construction and equipping works or completion of the rehabilitation works and with a minimum aggregate value of EGP100 million. The Cabinet of Ministers, upon the recommendation of the Supreme Committee for Public Private Partnership Affairs (the "Supreme Committee for PPPA"), may, if required due to a material public interest, agree to conclude a PPP contract for a term longer than 30 years.

Pursuant to the PPP Law, PPP projects may not be tendered except following the approval of the Supreme Committee for PPPA, following a request by the competent authority in light of studies prepared under the supervision of the PPP Central Unit at the Ministry of Finance. The PPP Law provides for contracting by way of direct award if:

- the state's need for the establishment of a project cannot be accommodated through contracting methods such as tender and public or limited auction, and there is an economic interest or a social necessity that requires its speedy implementation; or
- any of the project companies contracted with have finalised the implementation of a project in an efficient manner, and the Supreme Committee for PPPA estimated that re-awarding any of the works stipulated in Article 2 of the PPP Law to any of these companies to perform in the implemented project would have an economic or social interest that would not be achieved if re-awarded to a different entity.

Contracting for these works shall be by virtue of a new contract.

Limitations Under the PPP Law

Additionally, pursuant to Article 11 of the PPP Law, the assets pertaining to the implementation of the partnership contract may not be seized or enforced upon. Article 11 provides that "it is not permissible to seize or undertake any enforcement measures on the facilities, tools, machines or equipment designated for implementing the partnership contract and operating or exploiting the project. The project company may not sell the funds and assets of the project, which it may own in accordance with the partnership contract for the project and the facilities being established or developed, except for the purpose of implementing the replacement and renewal programme stipulated in the contract and after obtaining the approval of the competent authority or assign any right to them".

8.3 Governing Law

Certain national projects and programmes introduced by the government involve templates of previously set project documents that are governed by the Egyptian law. These agreements are typically entered into between the government or public sector entities and the project companies. Project contracts entered into between two or more private sector parties are also typically governed by local laws. It is worth noting that that the choice of foreign law to govern project agreements is acceptable provided that it does not contradict public order and public morality. Finance agreements that are between foreign lenders and the project companies are typically governed by a foreign law (for example, English law).

Further, as stated under **6.3 Foreign Court Judgments**, Egypt is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. As such, foreign arbitral awards are recognised and enforceable in Egypt if such awards are obtained in a state that is a party to the New York Convention. However, pursuant to Article 1 of the Arbitration Law No 27 of 1994 "[w]ith regard to disputes relating to administrative contracts, an agreement on arbitration shall be subject to the approval of the competent minister or any person assuming their jurisdiction with respect to public legal persons and it is not permissible to delegate such powers".

8.4 Foreign Ownership

Foreign ownership of property and usufruct rights are subject to certain conditions under Law No 230 of 1996. Foreign individuals or entities may own lands in Egypt subject to a limit of two properties, and within specific area limits.

8.5 Structuring Deals

Egyptian law does not provide for specific restrictions in relation to the form of the project company in the context of a project financing as this shall be subject to the type of each project and the relevant agreement executed between its parties (eg, project companies established in relation to energy projects under the feed-in tariff programme must be joint stock companies). One point to note when structuring the security package is that an upstream corporate guarantee by an Egyptian entity is only permissible to the extent that the guaranteed entity is not represented on the board of directors of the Egyptian company.

Restrictions on Foreign Investment

Generally, Investment Law No 72 of 2017 grants all investments (whether Egyptian or foreign investments) an equal and fair treatment and guarantees to foreign investors a treatment simi-

lar to that granted to national investors. Although there are no restrictions on foreign ownership as the company may be wholly owned by foreigners, there are legal restrictions on foreigner participation in certain activities, such as the following:

- Commercial agencies are required to be wholly owned by Egyptians or persons who have held Egyptian nationality for at least ten years.
- With respect to importation activities for trading purposes, whereby 51% of the shareholders must be Egyptians.
- Acquiring lands and/or real estate in the Sinai Peninsula (excluding the cities of Sharm El-Sheikh and Dahab, as per Presidential Decree No 128 of 2022), whereby the company is required to be wholly owned by Egyptians. Additionally, a company operating in the Sinai Peninsula (implementing investment and integrated development projects) must be established in the form of a joint stock company and 55% of its shareholders must be Egyptian. Certain approvals are required and restrictions are imposed on the foreign ownership. By way of exception to the aforementioned threshold, the requirement to have 55% Egyptian shareholders in companies that conduct the implementation of integrated development projects in the Sinai Peninsula may be exempted by virtue of a presidential decree issued in this regard. These companies must also obtain the necessary approvals from the Cabinet and other competent authorities to allow them to conduct their activities.

8.6 Common Financing Sources and Typical Structures

Projects are typically financed by a combination of both debt and equity and subject to a gearing ratio agreed between the lender and the borrower. Shareholders' loans are typically extended and may be subject to capitalisation throughout the tenor of the debt financing in order to maintain the agreed gearing ratio. Financing backed by export credit agencies is also a typical source of financing for projects.

8.7 Natural Resources

Natural resources are generally governed by the Egyptian Constitution, Law No 61 of 1958 as amended, in relation to the granting of concessions relating to investment in natural resources and public utilities, as well as the relevant law of the concession setting out regulatory and contractual terms.

The Egyptian Constitution prohibits disposing of natural resources as being a state public property. Granting the right to exploit natural resources or a concession to a public utility shall take place by law for a period not exceeding 30 years, while granting the right to exploit quarries, small mines and salterns (or granting a concession in this regard) shall be for a period not exceeding 15 years by law.

Noting that, the relevant law of the concession usually sets the licences and permits required to be obtained for the exploitation of the natural resources and the requirements that must be met by companies that are granted the right of exploitation or concession.

Mineral and salt materials may not be exported except upon the approval of the Egyptian Mineral Resources Authority. The exportation of critical primary materials enjoying strategic industrial value is prohibited unless the exportation is meant to add value to the material, or is part of an industrial project.

8.8 Environmental, Health and Safety Laws

Law No 4 of 1994 and its executive regulations issued by virtue of Prime Minister's Decree No 338 of 1995 (the "Environmental Law") is the general framework governing environmental, health and safety matters in relation to existing projects/upcoming projects in Egypt. Pursuant to the Environmental Law, the Egyptian Environmental Affairs Agency is the competent authority to issue environmental permits/approvals. Labour Law No 12 of 2003 has also provided for the provisions and regulations required to preserve occupational health, safety and security on work sites.

Additionally, there are other regulatory frameworks governing specific environmental, health and safety measures. For example, Law No 55 of 1977 and its executive regulations governing the establishment/operation of thermal equipment and steam boilers, along with obtaining the required management and operating permits, and Law No 119 of 2008 governing the specifications, obligations, and requirement for establishing a new building or modifying an existing building.

FRANCE

Law and Practice

Contributed by:
Pauline Larché-Dmitrieff, Yannick Le Gall, Alice Gaillard and Clément Maillot-Bouvier
De Pardieu Brocas Maffei

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De Pardieu Brocas Maffei

De Pardieu Brocas Maffei was founded in 1993 and is one of the leading Paris-based business law firms with an international reach. The firm currently has approximately 160 lawyers, including 40 partners, and offers its clients a global service that combines synergies between its teams and strong working relationships with its referral firms abroad. The firm's clients include many major French and international industrial, financial and service corporations. Its success is the result of its ability to provide creative and sound advice, tailored to client needs, in connection with large and complex transactions. Its teams have the capabilities to support clients in France and internationally in the following principal areas of business law: banking and finance, capital markets, M&A, securities law, private equity, real estate, tax law, restructuring and insolvency, dispute resolution, competition/merger control, intellectual property, energy, economic public law – regulated industries and employment law.

Authors

Pauline Larché-Dmitrieff is a senior associate member of the debt finance group of De Pardieu Brocas Maffei. She advises both financial institutions (banks and institutional lenders) and alternative lenders on one hand, and sponsors and borrowers (developers, real estate holdings, PE funds) on the other hand, on the structuring and implementation of corporate, investment (share and asset deals) as well as development financings of real estate assets and portfolios, including data centres. She also assists clients with restructuring financings (out-of-court or court-monitored proceedings) and is increasingly active in sustainable linked lending. She has also passed the sustainable finance certification from the AMF.

Yannick Le Gall is a partner member of the debt finance group of De Pardieu Brocas Maffei. His practice focuses primarily on leveraged finance (senior and junior) and capital market transactions. He advises both MLAs/banks as well as sponsors, private equity/debt funds and other institutional investors in both private and publicly traded companies. In addition, he regularly advises clients on real estate finance transactions (alongside the firm's real estate group) and on debt purchase transactions (performing or non-performing portfolios). Alongside the restructuring group, he advises clients on financing aspects of restructuring transactions.

Contributed by: Pauline Larché-Dmitrieff, Yannick Le Gall, Alice Gaillard and Clément Maillot-Bouvier,
De Pardieu Brocas Maffei

Alice Gaillard is a counsel member of the dispute resolution group of De Pardieu Brocas Maffei. She advises on regulatory litigation before the main independent administrative authorities and regulatory agencies in the banking, financial and stock market sectors, in particular the Autorité des marchés financiers, the Autorité de contrôle prudentiel et de résolution, the French Anti-Corruption Agency, the National Sanctions Commission. She has extensive experience in market abuse, such as insider trading, market manipulation, as well as in compliance, ethics and fraud. She advises and represents companies and their managers in the context of investigations or administrative controls initiated by national or foreign administrative authorities, and their sanctioning at all stages of the proceedings.

Clément Maillot-Bouvier is a counsel member of the restructuring and insolvency group of De Pardieu Brocas Maffei. He advises distressed listed or non-listed companies, shareholders, banks, debt funds and investors, in connection with debt restructuring, insolvency proceedings and distressed transactions. He has developed extensive experience in major French pre-insolvency and insolvency proceedings cases, as well as complex cross-border restructuring matters in a broad range of industries, especially with respect to distressed leveraged buyout (LBO) and project finance cases.

De Pardieu Brocas Maffei

57 Avenue d'Iéna
CS 11610
F-75773
PARIS
Cedex 16
France

Tel: + 33 1 53 57 71 71
Email: marketing@de-pardieu.com
Web: www.de-pardieu.com

DE PARDIEU BROCAS MAFFEI
AVOCATS

Contributed by: Pauline Larché-Dmitrieff, Yannick Le Gall, Alice Gaillard and Clément Maillot-Bouvier,
De Pardieu Brocas Maffei

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

A challenging interest rate environment in the last 12 months, inflation and energy costs have led to financial stress and several debt restructurings. Private equity funds and corporates may have been faced with squeezed liquidity, higher costs of fund and domestic banks tightening their standards, in a burdensome or sometimes unsustainable way for business plans already impacted by rising interest rates and high inflation. This situation has led to complex refinancings (including a mix of senior/junior/PIK/preferred equity structuring), numerous amend-and-extend requests on less favourable terms (notably when a pay-down is required) and, finally, debt restructurings. For this reason, cov-lite structures tend to evaporate, including for most established sponsors.

1.2 Impact of the Ukraine War

The war in Ukraine, in addition to wider geopolitical and economic volatility, has increased the uncertainty on the debt market and may have created turmoil for lenders and their ability to execute and perform their obligations. Arrangers and underwriters have tried anticipating those market challenges such as the potential escalation in the Ukrainian conflict, by including more systematically market-related material adverse change provisions in their commitment papers, thus affecting certain funds provisions. In addition, the conflict has also led to longer due diligence process because of heavier sanctions checks.

1.3 The High-Yield Market

There has been some inertia in the high-yield market in France.

1.4 Alternative Credit Providers

Alternative lenders are entrenched in the debt market alongside the banks, and have continued to step in to fill the gap in 2023; especially for mid-market financings that currently dominate, whilst mega-market deals have remained scarce. In an environment where loan maturities face funding gaps amidst higher interest rates, PE funds and corporates are turning to private credit solutions that may offer one-stop solutions providing debt and follow-on capital, including through preferred equity structures.

There is now a convergence between private debt documentation and the more restrictive banking documentation, likely as a result of portfolio management issues faced by alternative lenders, as well as to rationalise their expositions.

1.5 Banking and Finance Techniques

Banking and finance techniques have materially evolved to integrate ESG and sustainability considerations, including related reporting. In addition, and considering the combination of interest rate hikes, market conditions (tighter loan standards imposed by the banks) and lenders' appetite, other structures such as preferred equity structuring have continued to be a suitable alternative for borrowers.

1.6 ESG/Sustainability-Linked Lending

New companies have issued their first sustainability-linked bonds (SLBs). These SLBs are often linked to commitments to reduce greenhouse gas (GHG) emissions, including Scope 3 (Air-France KLM – EUR1 billion; Orange – EUR500 million; Carrefour – EUR500 million). To encourage the development of SLB, the ICMA has published a new version of its guidelines on SLB Principles. The AMF reiterated the benefits of these products while specifying that it would

be vigilant about greenwashing. Banking loans linked to sustainability criteria are also developing steadily. In 2023, after publishing an update of its "sustainability-linked loan principles", the LMA published a model documentation for these sustainability-linked loans. Entry into force of the CSRD directive and its ESRS in 2024 should increase the availability of more reliable and comprehensive ESG data.

As regards the impact on financial conditions, lenders increasingly reward success with margin reduction and more recently penalise failure through malus. Beyond usual commercial discussion on the KPIs and the magnitude of the margin reduction, the consequences of failure need to be agreed with a concern for fair treatment and short or medium-term remediation options, so as not to penalise the borrower on a long-term basis.

2. Authorisation

2.1 Providing Financing to a Company

Under French law, only licensed French and EU passported credit institutions and finance companies (*sociétés de financement*) are authorised to enter into credit transactions for consideration and on a regular basis on the French territory, it being specified that credit transactions include lending activities, the purchase of non-matured receivables, financial leases when the lessee is granted an option to buy the leased asset, as well as the issuance of personal guarantees. Certain other entities or funds (including *organismes de financement* and securitisation organisations) may also carry out lending activities under conditions.

However, French law provides various exceptions to the requirement to hold a banking licence, such as payment delays, loans granted within a group, cash collateral in the context of a securities lending operation, and purchase of non-matured receivables by foreign entities whose corporate purpose or activities are similar to those of the regulated entities which are authorised to lend in France under the French banking regulations (such as foreign banks). Bonds issuance also falls beyond the scope of the French banking monopoly.

In order to obtain a credit institution licence from the ECB (or a finance company licence from the ACPR), numerous and strict conditions must be satisfied, notably, minimum capital requirements, the activity must be effectively run by at least two people, whose knowledge, experience and appropriateness must be demonstrated, as must their availability, the operation programme must detail the various types of activities contemplated, the technical and financial means must be put into place to implement such programme, and the robustness of shareholders and other equity providers or guarantors must be demonstrated.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Foreign lenders shall comply with French banking monopoly rules described in **2.1 Providing Financing to a Company**. Subject to conditions defined by EU law, an entity authorised to carry out banking activities in a European Economic Area (EEA) member state is entitled, if it chooses, to carry out the same permitted activities in any other EEA member state by either exercising the right of establishment (through a branch or agents) or providing cross-border services. An exception to the banking monopoly was intro-

duced in 2017 allowing the transfer of unmatured receivables by a duly licensed French lender to assignee(s) not licensed in France subject to three conditions: the transferred receivables shall arise from credit operations granted by regulated entities, the transferee must have in its own country a similar activity and the debtor shall not be an individual acting for a non-professional purpose.

3.2 Restrictions on Foreign Lenders Receiving Security

There is no specific restriction under French law on the granting of security or guarantees to foreign lenders, it being however specified that the benefit of assignment of professional receivables by way of security (Dailly assignment pursuant to L.313-23 to L.313-34 of the French Monetary and Financial Code), is reserved to duly licensed or passported lenders in France or otherwise authorised funds.

3.3 Restrictions and Controls on Foreign Currency Exchange

There are no exchange controls regarding foreign currency exchange in France.

3.4 Restrictions on the Borrower's Use of Proceeds

Loan documentation generally provides for specific representations, warranties and further assurance provisions (usually not subject to remediation) from the relevant obligor that the loans/debt securities are subscribed for its own account, and it shall comply with sanctions and all applicable anti-bribery and anti-money laundering regulations.

3.5 Agent and Trust Concepts

The agent role in French-law governed credit documentation was routinely based on a civil law power of attorney (Article 1984 and seq. of the French Civil Code). In addition, a special security agent regime (Article 2284 and seq. of the French Civil Code) provides that a security agent may be appointed to be the direct holder of the security and guarantees created for the benefit of the creditors of the secured obligations, and such security agent may also file any claim in any bankruptcy proceedings. The security and guarantees are segregated from the security agent's own assets, together with any proceeds received by the security agent in that respect (management or enforcement).

Since a decision dated 13 September 2011, the French Supreme Court recognises parallel debt structures in foreign-law governed financings subject to French international public policy rules.

3.6 Loan Transfer Mechanisms

A loan transfer may be affected (in writing) by way of (i) assignment of rights (*cession de créances*), (ii) novation, (iii) assignment/transfer of agreement (*cession de contrat*) and (iv) assignment/transfer of debt (*cession de dette*).

The consent of (and notification to) the borrower in the loan transfer is required if such loan transfer is made under a transfer agreement (*cession de contrat*), transfer of debt (*cession de dette*) or novation. However, it is not necessary when a loan transfer by way of assignment of rights (*cession de créances*) occurs, although such assignment shall be raised to the borrower by mere notification.

3.7 Debt Buy-Back

Debt buy-back is generally permitted and based on LMA market standard provisions in syndicated loans/leverage financing; for private debt financing it is less common, but sponsors may

still approach their lenders to repurchase debt at a discount.

3.8 Public Acquisition Finance

Before launching a public takeover bid, financing must be secured and the initiator of the offer must select a presenting bank, which will file the offer with the AMF on its behalf. The filing must include a guarantee of the tenor and irrevocable nature of the commitments and must be accompanied by the draft offer document drawn up by the offeror that shall mention, among other things, the terms of financing for the transaction.

By law, the guaranteeing bank undertakes to settle the purchase price of the securities tendered as part of the offer (whether voluntarily or due to any mandatory squeeze-out mechanism). Consequently, guaranteeing banks rigorously ensure that the facility agreement (which does not need to be publicly disclosed or filed) does not grant lenders any "out" options during the certain funds period (except for very limited circumstances such as insolvency proceedings, change of control or payment default). It is standard for the guaranteeing bank to benefit from an autonomous first demand guarantee, be party to the facility agreement and be entitled thereunder to request utilisations (without any condition precedent applicable) on behalf of the initiator during a certain funds period to cover the undertakings of the initiator under the offer.

3.9 Recent Legal and Commercial Developments

Integration of ESG and sustainability considerations in bank and bond financing has slightly amended the legal documentation. Please see **1.6 ESG/Sustainability-Linked Lending**.

3.10 Usury Laws

French law provides usury rules applying to loans granted to consumers, therefore individuals acting for their professional needs or legal entities engaged in a professional activity fall beyond the scope of usury law. However, the prohibition of usury is extended to (i) account overdrafts, including those granted to legal persons engaged in a professional activity, (ii) contractual interest-bearing loans and (iii) other transactions similar to money lending (eg, instalment sales, credit facilities).

Any contractual loan granted at an overall effective rate which, at the time it is granted, exceeds by more than one-third the overall effective rate charged during the previous quarter by credit institutions and finance companies for transactions of the same nature involving similar risks, constitutes a usurious loan. The maximum legal rate is published periodically by the French central bank and differs according to the type of loan concerned.

From a civil law perspective, French law sanctions usury by reducing the interest received to the maximum authorised rate. The overpayment is then automatically deducted from the normal interest and, subsidiarily, from the principal of the debt. From a criminal law perspective, any person who grants or participates directly or indirectly in a usurious loan may be punished by two years' imprisonment and a fine of EUR300,000 (this does not apply to usurious account overdrafts).

3.11 Disclosure Requirements

There is no general rule under French law requiring the disclosure of loan agreements to an authority or client, and French law further provides a banking secrecy obligation prohibiting credit institutions from disclosing any informa-

tion pertaining to a client obtained within the context of its professional activity and which is of a confidential nature. By way of exception, information subject to banking secrecy must or may be disclosed in certain situations.

Credit institutions owe a duty of information on various aspects (including overall global rate) and are required to make disclosure pursuant to Regulation (EU) 2019/2088 (SFDR) for investment products with regards to ESG considerations. According to the Taxonomy Regulation, banking institutions now have to publish their Green Asset Ratio (assets aligned with the European Taxonomy/total assets covered by the balance sheet).

4. Tax

4.1 Withholding Tax

Payments of principal made by French borrowers/issuers to lenders/bondholders are not subject to withholding tax. No French withholding tax applies to interest paid by a French borrower/issuer unless such payment is made onto an account opened with a financial institution situated in a country or territory which is deemed non-co-operative within the meaning of Article 238-0 A of the French Tax Code (NCCT). If payment is made into an NCCT, French withholding tax must be levied at the rate of 75%, unless otherwise provided in the relevant tax treaty or unless the borrower benefits from an "escape" provision by demonstrating that the main purpose and effect of the transactions in respect of which the interest is paid is not to allow the location of such interest in an NCCT.

French borrowers/issuers cannot deduct from their taxable income interest (i) paid or accrued to beneficiaries domiciled or established in an NCCT or (ii) paid onto an account opened with a financial institution situated in an NCCT. Non-deductible interest could then be reclassified as a deemed dividend in respect of which a withholding tax obligation could arise.

In addition, fee payments made to non-French beneficiaries are subject under French law to a 25% French withholding tax unless the beneficiary of the payment can benefit from the tax treaty protection (since most of the tax treaties prevent France from applying such withholding tax).

4.2 Other Taxes, Duties, Charges or Tax Considerations

Most financial transactions are exempt from VAT in France. However, lenders may opt for VAT and send a written registration to the relevant tax office, which takes effect on the first day of the month following its submission until it is revoked (which is only possible from January 1st of the fifth year following the year in which the option is exercised). From 1 January 2022, a lender may decide to apply the VAT option only to eligible transactions of its choice (previously, the option was global).

French banks may be subject to bank levies by reference to their assets or liabilities, including the French *taxe pour le financement du fonds de soutien aux collectivités territoriales* (Article 235 ter ZE bis of the French Tax Code).

There are generally no stamp duties applicable to financing activities save for voluntary registration of the documentation or in relation to certain guarantees.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

As a result of the NCCT legislation, it is now common for French borrowers/issuers to seek to include provisions that exclude gross-up obligations in circumstances where French withholding tax is due as a result of payments being made onto a bank account in a jurisdiction which, as a result of a change in the list of NCCTs, finds itself in an NCCT.

Financing agreements involving a French borrower/issuer also generally provide for a right of repayment and cancellation for the borrower/issuer and a mitigation obligation for the lender in case interest becomes non-tax deductible as a result of being paid or accrued to the benefit of lenders domiciled or established in an NCCT or paid onto an account opened with a financial institution situated in an NCCT. Restrictions on transfers to lenders domiciled or acting through an NCCT and countries of location of the agent are also common.

It is increasingly common for French borrowers/issuers to seek to negotiate exclusions to the gross-up provisions on fee payments and to request the lenders to provide them with tax residency certificates before any fee payment.

5. Guarantees and Security

5.1 Assets and Forms of Security

Security interests over assets located in France generally required for standard collateral packages are as follows:

- pledge of securities account – security over securities which encompasses the cash proceeds attached to such securities (unless otherwise agreed); such pledge is created under a pledge statement (*déclaration de nantissement*) that includes mandatory provisions for validity purposes and is registered in the share transfer registry and in the pledged securities account;
- pledge over partnership interests – security over shares issued by limited or unlimited liability partnerships that requires an approval of the secured creditors by the shareholders; it must be registered with the registrar of the commercial court and be renewed after five years;
- pledge of receivables – security over receivables (present and/or future) that must properly identify the pledged receivables and pledged debtor(s);
- assignment of receivables by way of guarantee: either (i) the Dailly law assignment that can only be granted by a borrower acting in the course of its professional activity (ie, not as a guarantor/security grantor) to the benefit of the lender which extended the facilities then secured (ie, credit institution or other financial institution/funds otherwise licensed to carry out activities in France or authorised to benefit of such assignment), or (ii) the civil law assignment by way of guarantee (*cession civile à titre de garantie*) whose conditions are less restrictive than the Dailly law assignment, notification must be made to the debtor to receive payment;
- pledge over bank account – security over the positive balance of a bank account in the form of a pledge; the bank account holder must be notified of the pledge for enforceability purposes;
- pledge over business concern – security over trade name, the leasehold rights, goodwill and may be extended to fixed assets such as furniture, machinery, equipment and IP rights attached to the business under a pledge; registration is required for enforceability

purposes and is made on a registry called the *registre des valeurs mobilières* common to all movable security interests and be renewed after ten years;
- cash collateral – security by way of an assignment of monies whose regime is aligned with the civil law regime relating to assignments of receivables and, unless otherwise agreed, the beneficiary may freely dispose of such funds; and
- mortgages – can only be created pursuant a notarial deed with the assistance of a French notary and which will be further registered with the relevant land registry.

As regards the trust (*fiducie*), such security requires the transfer of the concerned rights and assets to the trustee (*fiduciaire*) acting in favour of the secured creditor. The assets held by the trustee of the security trust are segregated. To be valid, a trust agreement must be registered with the local tax authorities within one month of its signing.

Registration always requires the payment of fees or taxes and a renewal on occasion to maintain the effectiveness and ranking of the security interests. All registered security interests must be drafted in French for validity or perfection purposes and shall address all the relevant (mandatory) information required by law to be validly received by the relevant registrar. They can however be signed electronically pursuant to Articles 1366 and seq. of the French Civil Code, it being recalled that under French law, agreements may not be executed by counterparts.

5.2 Floating Charges and/or Similar Security Interests

French law does not provide for floating charge, which means that all the security interest corresponding to the debtor's available assets must be combined in order to achieve the effects of the floating charge as far as possible.

5.3 Downstream, Upstream and Cross-Stream Guarantees

Under French corporate law, a company has a corporate interest distinct from that of its shareholders or affiliates even in the case of a wholly owned subsidiary. If the contemplated transactions, such as the granting of security or guarantees, are detrimental to the guarantor's corporate interest, it may be characterised as a misuse of credit or misappropriation of company assets pursuant to paragraph 3 of Article L. 242-6 of the French Commercial Code. The president, the general managers or the directors at fault may be subject to criminal sanctions. Lenders may also be potentially exposed to the risk of being held liable as accomplices under those violations (same article).

Under prevailing French case law, security interests or guarantees granted by a subsidiary in order to guarantee the obligations of its parent company or another company within the same group do not constitute a misuse of credit or misappropriation of company assets if the following conditions are satisfied:

- the guarantor and the company or companies whose undertakings are being guaranteed must belong to the same group of companies that must be a coherent economic entity with actual commercial and economic relations (as opposed to a mere conglomerate);
- the delivery of the guarantee must be in the common interest of the group and result in overall benefits (different than the aggregate benefits of its members), be granted in accordance with a policy defined for the group as a whole and not be in the sole inter-

est of the dominant company or its majority shareholders; and
- the issue of the guarantee or the granting of security interest by the subsidiary should not be contrary to the corporate interest of such subsidiary.

When enforcing these principles, the courts will always consider the circumstances of each particular transaction and tend to have a very strict approach.

Lastly, in case of opening of bankruptcy proceedings against a given debtor, if a creditor is held liable by a French court for damages resulting from the credit facilities granted to such debtor, the security and/or the guarantees guaranteeing such credit facilities will be null and void. French law provides that the creditors could be held liable by a French court only in case of fraud, interference (*immixion*) of the creditor in the management of the debtor or in the situation where the security interest and/or the guarantees obtained in consideration of the credit facilities are disproportionate to the credit facilities (see Article L. 650-1 of the French Commercial Code).

5.4 Restrictions on the Target

As regards a target granting guarantees or security, French law prohibits the use by a French limited liability company of its assets or credit to finance the purchase or the subscription of the company's own shares. This applies to the granting of security by a company to secure the acquisition or the subscription of its own shares and gives rise to criminal sanctions (see Article L. 225-216 of the French Commercial Code). According to most legal scholars, this law should be interpreted restrictively as its violation gives rise to criminal sanctions. However, a minority of scholars adopt a broad interpretation and consider that the prohibition of financial assistance may still apply to the indirect acquisition of shares of a company acting as guarantor under the acquisition financing, for instance.

Financial assistance shall also be considered when merging the borrower and the target, or when implementing debt pushdowns financed by external indebtedness subscribed by the target to refinance the acquisition debt at the end.

It is generally admitted that in case of financial assistance, the guarantees granted by the guarantor can be voided by the French court.

5.5 Other Restrictions

A certain number of transactions/acts, such as security and guarantee, can be challenged by the judicial administrator, the creditors' representative or the liquidator or the Public Prosecutor (*Ministère Public*), if they have been granted during the hardening period.

No consent is required with respect to the creation of security unless foreign investment control regulation applies to the relevant assets over which security is created, or except for the prior consultation of the works council of a company (if any) when the granting of the relevant security involves any question on the organisation, management or general conduct of the company.

5.6 Release of Typical Forms of Security

The contractualisation of a deed of release generally applies to the parties when external debt repayment has occurred, and related security shall be released. Such release agreement pertaining to French law security may be governed by the same foreign law governing the underlying credit documentation even though it remains necessary to draw up a specific release agreement, drafted and governed by French law,

when the release must be filed with a specific French register.

5.7 Rules Governing the Priority of Competing Security Interests

Beyond contractual priority arrangements provided by the intercreditor agreement for governing various groups of secured creditors, the priority of competing security is dealt with by the security itself and its perfection or registration, depending on the nature of the security. If the security is subject to registration, the ranking of the security interest is determined by the date of registration. Otherwise, the ranking of the security is determined by the date on which the relevant perfection of that security is completed.

There are essentially two ways of implementing subordination, either structural subordination through dedicated capital structures to spread the senior/junior/PIK debts at different levels with separate covenants and collaterals; or contractual subordination through subordination/intercreditor agreement.

As regards contractual subordination, Articles L 626-30 and L 631-19 of the French Commercial Code provide, in the context of safeguard, accelerated safeguard and rehabilitation proceedings, that when classes of affected parties must be summoned, the formation of the classes must comply with intercreditor/subordination agreements entered into by the affected parties before the commencement of the proceedings. The affected parties shall notify the existence of such agreements within ten days. Otherwise, they will not be unenforceable in the context of the proceedings. To date there is at least one precedent where senior and subordinated lenders voted in separate classes based on an intercreditor/subordination agreement.

5.8 Priming Liens

As matter of principle, a security which is duly enforceable against third parties will not be primed by other security arising by operation of law except as follows:

- employees' general privilege, which guarantees payment of remuneration (wages and certain allowances) owed to employees for the last six months. This privilege applies to the employer's movable (third rank) and immovable (second rank) property; and
- by the effect of specific payment waterfall in the framework of insolvency proceedings, as detailed in **7.2 Waterfall of Payments**.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Under French law, enforcing collateral requires unpaid sums – ie, payment default when principal or interest are due and payable or a notified acceleration; it being specified that security arrangements such as trusts (*fiducie-sûreté* or *fiducie gestion*) or golden share arrangements may however contractually provide for specific rights for the beneficiaries anticipating the payment default.

As regards means of enforcement, creditors have the choice between appropriating the collateral and/or disposing of it, either by way of judicial proceedings (judicial foreclosure or public auction) or, depending on the type of security, by way of private appropriation as a result of contractual enforcement provisions (*pacte commissoire*) in the relevant security agreement. Enforcement under judicial proceedings may take some time while contractual enforcement may be swift, provided that the relevant security

provider does not benefit from an automatic stay resulting from insolvency proceedings.

6.2 Foreign Law and Jurisdiction

Foreign Law

As regards contracts concluded in civil and commercial matters, the effectiveness of a clause on governing law, according to the Rome I Regulation, depends on whether it forms part of a domestic or international contract. In accordance with the Rome 1 Regulation:

- where the contract is domestic – ie, its main characteristics (nationality of the parties, place of performance, etc) are located within the same State, the clause is valid, but cannot derogate from the mandatory rules of the law of that state (Article 3.3); and
- where the contract is international – ie, there is a foreign element, the choice of law is valid and may derogate from the mandatory rules of French law. However, public policy of the forum (Article 21) and overriding mandatory provisions (Article 9), may occasionally render the will of the parties ineffective,

it being specified that certain matters are excluded from the scope of the regulation (Rome I Regulation, Article 1.2).

Foreign Jurisdiction

Cases of international disputes before French courts are as follows:

- if the clause designates a French court, Article 25 of the Brussels I recast Regulation regulates the form and substantive validity of the jurisdiction clause – ie, it is subject to the law of the state to which it confers jurisdiction, and French law requires that the parties have validly agreed to the jurisdiction clause;
- if the clause designates the jurisdiction of an EU member state, but French courts are nevertheless seized of the dispute, they will uphold the jurisdiction clause if it complies with the Brussels I recast Regulation requirements; and
- if the clause designates a jurisdiction of a non-EU member state, but French courts are nevertheless seized of the dispute, rules of French private international law apply and provide that jurisdiction clauses are, in principle, lawful in international disputes.

Finally, the clause may be asymmetrical by allowing one of the parties the right to bring proceedings either before the court or courts designated in the clause, or before any other competent court or the courts of another state. Such a clause is valid only if it specifies the objective elements on which this alternative jurisdiction is based and must not be contrary to the objective of foreseeability and legal certainty. It should be highlighted that a decision of the EUCJ is expected shortly as to whether the validity of asymmetrical jurisdiction clauses shall be subject to EU member domestic laws or to EU Law.

Waiver of Immunity

The waiver of immunity may concern immunity from jurisdiction or immunity from enforcement. On one hand, immunity from jurisdiction allows a state not to be judged by anyone other than its courts. This waiver is valid under certain conditions. The French Supreme Court has held that if a state may waive its immunity from jurisdiction in a dispute, this waiver must be certain, express and unequivocal (*Cour de Cassation*, 9 March 2011, No 09-14.743). On the other hand, immunity from enforcement enables a state to protect its assets from measures of execution, such as seizures. The "Sapin II Act" (9 December 2016) codified the conditions under which a

state may effectively waive this immunity. The waiver must essentially be express and, for diplomatic assets, special (French Civil Enforcement Proceedings Code, Article L. 111-1-2). Also, enforcement proceedings may only be implemented on property belonging to a foreign state with the prior authorisation of the judge (French Civil Enforcement Proceedings Code, Article L. 111-1-1).

6.3 Foreign Court Judgments

A foreign judgment or arbitral award will not require a retrial of the merits of the case to be enforceable in France. The rules on the enforcement of a foreign judgment depend on whether the judgment is issued by a member state of the EU (Brussels I recast Regulation will apply) or by another foreign jurisdiction (French Civil Procedure Code will apply). In any case, the foreign decision or the award must comply with French international public policy.

6.4 A Foreign Lender's Ability to Enforce Its Rights

There is no specific matter that might impact a foreign lender's ability to enforce its rights except when the enforcement of a security interest would result in the crossing of a certain threshold of share capital and/or voting rights or the acquisition of the control of a French company carrying out "sensitive activities" (such as activities likely to affect the interests of national defence, involved in the exercise of public authority) by a foreign investor where a prior approval of the French Minister of the Economy may be required.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

French law provides for two types of restructuring proceedings. Firstly, pre-insolvency proceedings which are flexible, voluntary and confidential proceedings and secondly, insolvency proceedings which are formal and public proceedings.

Effects of Restructuring Proceedings on Acceleration

The opening of pre-insolvency and insolvency proceedings (other than liquidation) shall not be a valid cause of acceleration. Notwithstanding any contractual provisions, creditors are prohibited from accelerating a loan by the sole reason of the opening of such proceedings (or of any filing for that purpose). More generally, any contractual provision increasing the debtor's obligations (or reducing its rights) by that sole same reason is also null and void. However, in theory (it has been recently refused by some jurisdictions) a lender can accelerate for other types of events of default. It should, however be remembered that acceleration will have no impact on the general prohibition to pay pre-filing claims.

In liquidation, all claims become immediately payable when proceedings are opened (unless business activities are expressly continued by the court on a temporary basis to ensure the preparation of a sale plan – in this case, claims become immediately payable when the court approves the sale plan or when the temporary continuation of business ceases).

Effects of Restructuring Proceedings on Enforcement

On one hand, the commencement of pre-insolvency proceedings does not trigger any stay of payment nor enforcement actions. Yet, the debt-

or can apply for a moratorium (for a maximum of two years) if any creditor attempts to enforce its rights while proceedings are pending or, in conciliation only, if such creditor refuses to grant a standstill for the duration of the proceedings (maximum five months). On the other hand, the commencement of an insolvency proceeding triggers an automatic stay on (i) enforcement of payment obligations incurred prior to the opening of the proceeding and (ii) enforcement on related security over the assets of the debtor (including security interests granted over in guarantee of a third-party's debt). In addition, any increase in the scope of security interests or retention right is strictly prohibited. In other words, the debtor is prohibited from paying its pre-filing creditors, which are prohibited from enforcing the rights. Nonetheless, there are limited exceptions including the right to set off applicable to:

- reciprocal debts with the insolvent debtor, limited to related debts (*créances connexes*) subject to conditions;
- financial obligations arising under certain financial contracts (notably derivatives); and
- some security interests may allow creditors to recover their pre-petition claims during the observation period, such as claims secured by a security conferring a retention right, claims assigned by of Dailly assignment or claims secured by a trust (*fiducie*).

7.2 Waterfall of Payments

Statutory Ranking

The distribution of the company's value follows a predetermined rank order, but the exact recoveries are rather unpredictable ex ante due to the high number of context-sensitive privileges. Nonetheless, the following basic principles apply.

- In safeguard or rehabilitation proceedings – the ranking has limited application as creditors are usually paid pursuant to safeguard/reorganisation plans that are not based on the disposal of the debtors' assets. It is however relevant where disposals of secured assets are implemented during the observation period or under the plan. In these limited circumstances, the ranking would usually be in the following order (ranking may slightly differ for immovable assets and assuming employees' pre-filing claims will be repaid pursuant to the plan): (i) employees' super-privilege (wages and all other forms of remuneration owed to employees (or former employees) for the last 60 days of effective work prior to the opening of proceedings), (ii) post-petition court costs which arose for the purpose of the proceedings, (iii) pre-petition claims benefiting from the "New Money" privilege, (iv) post-petition claims (in a nutshell in the following order: post-petition wages, post-petition new money facilities benefiting from the "Post Money" privilege, other post-petition claims for the purpose of funding the observation period or consideration in a business transaction), (v) pre-petition secured claims, (vi) pre-petition unsecured claims and (vii) shareholders claims; and
- in liquidation proceedings – the priority rules of claims are the same, save for pre-petition claims secured by a mortgage that rank ahead of the post-petition claims benefitting from the statutory "Post Money" privilege,

it being specified that security with a retention right allows the beneficiary to benefit from an exclusive right over the proceeds of the isolated sale of the affected assets. Similar exceptions apply to Dailly assignments and trusts (*fiducies*).

Contractual Ranking

Contractual Ranking contemplates two situations:

- pre-insolvency proceedings must comply with all contractual provisions, including those creating contractual priorities amongst creditors, unless otherwise agreed by all parties; and
- in safeguard (including accelerated safeguard) and rehabilitation proceedings, contractual ranking is considered to a different extent depending on the set-up or the absence of classes of affected parties. On one hand, set-up of classes of affected parties must comply with intercreditor/subordination agreements entered into prior to the opening judgment and notified to the administrator. This rule may be departed from if this is deemed necessary and does not excessively prejudice the rights of affected parties. On the other hand, when creditors are consulted on an individual basis, contractual ranking is not expressly dealt with by the French Commercial Code. Practitioners mainly consider that the draft plan may provide for a differential treatment amongst creditors if it is duly justified by different situations, however, this issue has not been definitively ruled by French courts and remains debated. The court can also impose on dissenting creditors a ten-year maximum term-out, with the same instalments for all dissenting creditors, and as such the uniformity of a term-out scenario appears as contrary to any form of subordination between creditors. In any case, it is usually considered that so-called "turnover" clauses shall remain applicable, since they only bind creditors between themselves.

7.3 Length of Insolvency Process and Recoveries

Any restructuring process can be divided in two distinct phases as follows:

- the restructuring proceeding itself – each proceeding has its own rules regarding length. For ad hoc proceedings there is no statutory time limit, but the process usually lasts from one month to one year; for conciliation proceedings, the length is up to four months maximum (extension is possible but the total duration cannot exceed five months); for safeguard proceedings, the length is 12 months maximum; for rehabilitation proceedings, 18 months maximum; and for liquidation proceedings there is no statutory time limit (as long as necessary to liquidate all assets); and
- the implementation of the restructuring plan approved further to restructuring proceedings – the duration of the implementation phase depends on the content of the restructuring transaction and the framework in which it was approved. As regards debts write-off of debt-to-equity swaps, the implementation phase is by nature very short. As regards debts, rescheduling extension of maturity is usually shorter in pre-insolvency proceedings (usually one to five years, with a repayment sometimes based on refinancing prospects) than in insolvency proceedings (usually five to ten years, it being specified that the court has the option, in certain circumstances, to impose a ten-year term-out plan to dissenting creditors).

Prospects of recovery for creditors depend on the nature and outcome of the restructuring proceedings:

- pre-insolvency proceedings usually lead to the signature of a restructuring agreement, which sets out the debt repayment terms based on the company's repayment capacity (more than its value); as consensual processes, the prospects of recovery will depend on what creditors have accepted in this context (write-off, rescheduling, etc); and
- insolvency proceedings have two main possible outcomes:
  (a) adoption of a restructuring plan (safeguard and rehabilitation proceedings) and for companies of a certain size, classes of affected parties are consulted and the agreement between some creditors may allow for the cram-down of other affected parties (subject to multiple conditions) whilst for other companies (or, in rehabilitation when the consultation of classes of creditors has failed), the court can impose a ten-year term-out plan upon dissenting creditors; or
  (b) the sale of business and assets of the debtors if the adoption of a restructuring plan is impossible, with the creditors being repaid out of the proceeds in accordance with the statutory waterfall.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

French insolvency law offers pre-insolvency proceedings (ad hoc and conciliation proceedings) which are flexible, voluntary and confidential proceedings that aim to facilitate workouts between a distressed company and all or part of its major creditors under the supervision of a court-agent. They are frequently used as a first step to engage financial restructurings. Their attractiveness is also due to their confidentiality.

Ad hoc and conciliation proceedings are very similar and share the following key characteristics:

- voluntary processes that do not trigger any automatic stay of payment nor enforcement action. Yet, the debtor can apply for a moratorium (for a maximum of two years) if any creditor attempts to enforce its rights while proceedings are pending or, in conciliation only, if such creditor refuses to grant a standstill for the duration of the proceedings;
- their opening does not affect the normal performance of contracts; it being recalled that under French law, ipso facto provisions increasing the debtor's obligations (or reducing its rights) are deemed null and void; this does not offer any protection in case of cross-default provisions and such protection is not recognised outside of France and thus only applies to French assets; and
- the workout agreement accepted by some creditors cannot be imposed onto other dissenting or silent creditors because the process is fully consensual. In practice, majority rules provided for in the existing credit documentation apply.

7.5 Risk Areas for Lenders

Three main risks for lenders if the borrower, security provider or guarantor were to become insolvent are (i) the risk of clawback and hardening period, (ii) the risk of liability and (ii) the risk of shadow directorship.

- In the framework of rehabilitation or liquidation proceedings, the court determines the date on which the debtor is deemed to have become insolvent within the 18 months

preceding the date of the judgment opening the proceedings. This marks the beginning of the so-called hardening period. Certain transactions entered into by the debtor during the hardening period are automatically void, whereas some are voidable by the court. Void transactions are those that constitute voluntary and unjustified preference for the benefit of some creditors to the detriment of other creditors.

- Indemnification actions may be launched against the lender of a distressed company, to obtain the indemnification of a damage suffered, should it be construed as a direct result of the lender's tort. In a nutshell, liability in tort could arise on two main bases – the lender's wrongful financial support and/or its wrongful termination of ongoing financing agreements.
- Under certain circumstances, lenders may be considered as a de facto director because of their influence on the company's management, exposing themselves to the risks attached to the quality of a director of a distressed company. In a nutshell, de jure and de facto directors can be held personally liable to pay all or part of the company's net debts (ie, debts left unsatisfied after the liquidation proceeds have been distributed to creditors) if they are held liable for mismanagement.

8. Project Finance

8.1 Recent Project Finance Activity

Despite a slight slowdown in activity at the beginning of 2023 due, in particular, to rising interest rates and high inflation, the French project finance market has remained active, driven in particular by the environmental transition, mobility and transport sectors. In addition to the consistently large number of projects in France to finance photovoltaic plants and wind farms (onshore or offshore), the last couple of years have witnessed the emergence of new assets supported by project finance, such as battery manufacturing plants for electric vehicles, charging stations for electric vehicles, hydrogen production sites, etc.

8.2 Public-Private Partnership Transactions

Two types of public-private partnership are mainly used in France. Firstly, the concession agreement, which is an administrative contract pursuant to which the public entity entrusts to a private partner the execution of works and/or the operation of a service in exchange for the right to operate the works or service.

Secondly, the partnership contract, which is an administrative contract pursuant to which the public entity entrusts to a private partner the global mission of construction, transformation, renovation, dismantling or destruction of works, equipment or intangible assets required for a public service or the exercise of a mission of general interest and, as the case may be, the operation and maintenance of the public infrastructure.

The main difference is that under a concession agreement, the compensation of the concessionaire will mainly arise from payments made by users of the service (meaning that the private partner bears an operating risk, which is the main characteristic of a concession agreement under French law) whilst under a partnership contract, the public entity will pay a rent to the private partner in exchange of the performance of the mission. In particular, under a partnership contract, the public entity pays to the private partner an investment rent in exchange for the completion of the investments.

The legal framework for partnership contracts requires the public entity to carry out a prior assessment and a study of budgetary sustainability before using a partnership contract. For this reason, most of the public-private partnership transactions are now structured in the form of a concession agreement.

8.3 Governing Law

Under French law, there is no restriction on the project documents being governed by a law other than the French law. The choice of the law applicable to the contract is governed by a principle of freedom for the parties. Gradually accepted and then clarified by French case law, this principle was enshrined in Rome I Regulation but remains subject to mandatory provisions and policy rules under French law.

Furthermore, under French law there is no restriction on the parties to the project documents (assuming that these contracts are entered into in the course of their professional activity) to submit the settlement of disputes arising from the performance of the contract to the courts of a country other than France to international arbitration.

8.4 Foreign Ownership

Under French Law, foreign investment control regulation applies when the following three conditions are met (unless specific exceptions apply): (i) the carrying out of an investment transaction (ii) by a foreign investor, (iii) in a sensitive activity. Any investment that falls within the scope of the French foreign investment regulation is subject to the prior authorisation of the French Ministry of Economy.

For instance, activities considered as sensitive will be those likely to affect the interests of national defence, involved in the exercise of public authority or likely to affect public order and public safety, when they relate to infrastructure, goods or services essential to guarantee the integrity, security or continuity of water supply.

8.5 Structuring Deals

One of the main features of project finance is that the project is carried out by a dedicated vehicle which raises external financing to (partially) fund the design, construction and operation of the project without any recourse against the sponsors (above their equity commitments), the lenders being repaid by the income generated by the project.

The first issue to be considered by the sponsors is the choice of the legal form of the project company. The sponsors can choose to enter into a joint venture or consortium (unincorporated association), a partnership, a limited partnership, or an incorporated entity such as a simplified joint stock company (*société par actions simplifiée*), that is the most commonly used given the limited liability (up to the equity contributions) of the shareholders and the flexibility of operation and management of this type of company under French law. The second issue to be considered by sponsors relates to their respective roles in the project (including in the funding), in the management bodies of the project company and the conditions pursuant to which a sponsor will be able to transfer its participation in the share capital of the project company.

Due to the absence of recourse against the shareholders, the main issue to be considered by the lenders when structuring the deal is the risk allocation between the project parties (EPC contractor, operator, offtaker, etc) and the residual risks remaining at the project company's level. The structuring of the security package is

also key for the bankability of the project, enabling lenders, in a worst case scenario, to have access to the project assets (mortgage, pledge over movable assets, pledge over receivables, etc) and to the shares of the project company, it being specified that the structuring of the security package will depend on the level on which the external financing is raised. Typically, the structuring of the security package will differ depending on whether the external financing is raised directly by the assetco or by a holdco (the incorporation of a holdco to raise the external financing could be the case for instance in case of financing a portfolio of projects).

8.6 Common Financing Sources and Typical Structures

From the outset and irrespective of the nature of the external financing raised by the project company, the debt providers usually require the sponsor a minimum level of equity, to a greater or lesser extent depending on the nature of the project and the risks identified.

In addition to equity financing, the main financing source used in France for project financing remains bank financing within the form of loans. Bonds are not commonly used, as such financing is more complex to implement where the funds are made available as the work progresses and as the rules governing the bondholders' representation and voting rights are less flexible (even if Ordinance No 2017-970 of 10 May 2017 has simplified the rules for bonds issuances reserved for qualified investors). Bond financing mainly concerns projects where sponsors have to broaden the pool of debt providers to entities which, as a result of the banking monopoly, are not allowed to make available funds in the form of loan. In this respect, it should however be noted that the rules governing the banking monopoly have recently been relaxed (Ordinance No 2017-1432 of 4 October 2017, modernising the legal framework for asset management and debt financing), allowing certain investment funds to grant financing in the form of loans (direct lending). Depending on the nature of the project, the sponsors may also obtain financing from institutional lenders such as for instance, EIB, Bpifrance, CDC or AFD or obtain subsidies from public institutions or territorial entities.

Bridge financings made available by certain investment funds are used more often, allowing sponsors to raise external financing during the project development phase (such bridge financing being refinanced by a traditional long-term bank financing raised once the project has reached the ready-to-build phase). This is particularly the case for renewable energy projects, for which the availability of bank financing is usually contingent upon delivery of the required administrative authorisations and securing land rights, thus preventing the project company from raising external financing during the development phase of the project.

8.7 Natural Resources

This is not an area covered by the authors.

8.8 Environmental, Health and Safety Laws

French environmental law aims to prevent industrial risks, manage waste, water and polluted soil, prevent adverse environmental impacts and protect biodiversity. Depending on the nature of the project, prior authorisation must be delivered by the state services to build and/or operate the project in accordance with the environmental laws. These projects mainly concern installations, activities, works or projects likely to present inconveniences or dangers for health and the various interests protected by the French Environmental Code.

In order to simplify administrative procedures and improve visibility for project developers, a single environmental authorisation was created by Ordinance No 2017-80 of 26 January 2017, bringing together the various procedures and decisions required for installations classified for environmental protection (ICPE) and installations, works, and activities subject to water law (IOTA), subject to authorisation.

Installations subject to environmental authorisation are also subject to inspection and monitoring by the state services in charge of environmental protection (*Direction régionale de l'environnement, de l'aménagement et du logement*- DREAL). Depending on breaches of environmental law that may have been observed, the DREAL may impose additional requirements, apply financial penalties or even withdraw the environmental authorisation.

French labour law contains several rules designed to protect the health and safety of employees. On construction sites in particular, inspections are carried out by the state services of the Ministry of Labour to ensure that construction companies comply with labour law and health and safety regulations applicable to their employees and to their subcontractors.

Trends and Developments

Contributed by:
Pauline Larché-Dmitrieff and Yannick Le Gall
De Pardieu Brocas Maffei

De Pardieu Brocas Maffei was founded in 1993 and is one of the leading Paris-based business law firms with an international reach. The firm currently has approximately 160 lawyers, including 40 partners, and offers its clients a global service that combines synergies between its teams and strong working relationships with its referral firms abroad. The firm's clients include many major French and international industrial, financial and service corporations. Its success is the result of its ability to provide creative and sound advice, tailored to client needs, in connection with large and complex transactions. Its teams have the capabilities to support clients in France and internationally in the following principal areas of business law: banking and finance, capital markets, M&A, securities law, private equity, real estate, tax law, restructuring and insolvency, dispute resolution, competition/merger control, intellectual property, energy, economic public law – regulated industries and employment law.

Authors

Pauline Larché-Dmitrieff is a senior associate member of the debt finance group of De Pardieu Brocas Maffei. She advises both financial institutions (banks and institutional lenders) and alternative lenders on one hand, and sponsors and borrowers (developers, real estate holdings, PE funds) on the other hand, on the structuring and implementation of corporate, investment (share and asset deals) as well as development financings of real estate assets and portfolios, including data centres. She also assists clients with restructuring financings (out-of-court or court-monitored proceedings) and is increasingly active in sustainable linked lending. She has also passed the sustainable finance certification from the AMF.

Yannick Le Gall is a partner member of the debt finance group of De Pardieu Brocas Maffei. His practice focuses primarily on leveraged finance (senior and junior) and capital market transactions. He advises both MLAs/banks as well as sponsors, private equity/debt funds and other institutional investors in both private and publicly traded companies. In addition, he regularly advises clients on real estate finance transactions (alongside the firm's real estate group) and on debt purchase transactions (performing or non-performing portfolios). Alongside the restructuring group, he advises clients on financing aspects of restructuring transactions.

Contributed by: Pauline Larché-Dmitrieff and Yannick Le Gall, **De Pardieu Brocas Maffei**

De Pardieu Brocas Maffei

57 Avenue d'Iéna
CS 11610
F-75773
PARIS
Cedex 16
France

Tel: + 33 1 53 57 71 71
Email: marketing@de-pardieu.com
Web: www.de-pardieu.com

DE PARDIEU BROCAS MAFFEI
AVOCATS

Introduction

The French debt market over the past 12 months has been relatively quiet for several reasons, the obvious ones being the interest rate hikes, the high inflation that has heavily impacted certain industries, a low M&A activity and finally the fact that banks have been tightening loan standards, even before the SVB failure – the largest bank failure since the 2008 financial crisis – which affected debt availability. Although inflation is set to become less of a concern, markets are now anticipating a risk of recession, which is becoming more likely, considering an environment where central banks are done, or nearly done with tightening, and close to peaking, according to a shared vision of relevant markets.

In this particular macroeconomic context, refinancing has become an issue compounded by the so-called wall of refinancing. Market analysis shows that a substantial amount of outstanding loans matures in the next three years, whilst debt availability is lower than the volume of maturing loans. In other words, loan maturities are facing a funding gap. This situation has led to two main trends in the French debt market which should continue in the coming year. On one hand, a different distribution of loans between various types of lenders to address the funding gap and, where refinancing reaches a dead end, a large number of "amend and extend" (A&E) transactions on the other hand.

Landscape of Active Lenders

Overview of the main categories of lenders

Lenders can schematically be divided into four categories, (i) commercial banks, (ii) investment banks, (iii) insurance companies and (iv) private debt funds. Each category is subject to its own regulatory framework, a specific economic approach and consequently different objectives. An analysis highlights that lender appetite is dependent on capital source.

On the one hand, commercial banks and investment banks were both impacted by higher rates and higher cost of funds as well as tighter lending conditions due to liquidity and credit risk considerations (including forbearance/backstop considerations – see below the discussion on key A&E parameters and considerations), thus affecting debt availability on a larger scale. Consequently, banks tend to be more selective for new situations and naturally focus on manag-

ing their book, hence creating opportunities for proactive management. This is particularly true in jurisdictions like France where banks entertain longstanding relationships with their clients compared to in the UK or US.

On the other hand, if insurance companies still have plenty of capital to deploy, since they aim towards a long-term liability matching, they take longer tenors and select lower risk investment, thus reducing the scope of their potential investments.

Last, private debt funds are seeking higher returns to match their investors' expectations and therefore can bear higher risk. In the former low-rate environment, private debt funds were ipso facto less competitive whereas the current environment offers growth opportunities to players more willing to underwrite inherent risk and able to provide liquidity.

Alternative lenders expected to demonstrate growth

While traditional lenders and borrowers are trying to navigate those severe market challenges, higher debt cost and less competition represent opportunities for private funds and alternative funds that go beyond mere mispriced opportunities, thus allowing them to enter the "senior" lending space to fund the liquidity gap without compromising their market-industry IRR requirement or their search for quality risk.

As a consequence, during the last 18 months, alternative lenders capable of underwriting big tickets have been able to provide, in France, senior secured financings that would previously have been typically underwritten by banks and then syndicated or sub-tranched in favour of private debt funds seeking higher returns. Following this trend, an increasing number of private equity funds are turning to private credit and setting up dedicated funds as a way to ensure returns in an environment where buyout transactions have become rarer and less profitable overall.

However, alternative lenders do not usually sacrifice due diligence in favour of higher returns. To the contrary, they appreciate their risk and inherent opportunities further to comprehensive due diligence including, as the case may be, enforcement scenarios, before implementing any given financing.

Key A&E Parameters and Considerations

As a consequence of current market conditions, A&E deals have represented a large part of the lending space as a pragmatic and temporary response to the wave of refinancings hitting a debt market still shaken by fierce headwinds. This continues, to some extent, the trend started during the pandemic when lenders adopted a wait-and-see approach by extending financings and/or suspending covenants. The result of these decisions has been to kick the can down the road and, with renewed uncertainty, a fallout seems inevitable. Pushing out the loan and bond maturity wall should continue to drive activity in the debt market for the next 12 to 18 months, regardless of the type of financing, save for certain industries or asset classes (such as data centres, biotech or telecommunications).

For the first time in more than a decade, sponsors face an uneven playing field: a refinancing offer dried up by the combination of the pause of European leverage finance and high-yield markets since 2022 and banks' review of lending strategic sectors, with less advantageous financial conditions (eg, financial costs and protection covenants), compared to those of their existing

financing, which, for some, are already difficult to sustain.

On the lenders' side, volatile debt markets and more guarded sector strategy have influenced and will continue to influence borrowing and lending decisions, including changing levels of acceptable credit risk to the existing terms and documentation and coupon/fees for extending. The situation is not easier for CLO investors, as their weighted average tests and/or investment window may, in certain cases, restrict them from rolling debt.

For deals that do not fly off the shelves (eg, existing material deviation of business plan, volatile asset valuations and fears of market corrections), options are really tight and come down to rescue or distressed financings with more onerous bridge loans or, ultimately, a workout situation. This causes asset fire sales to meet redemptions in a market that is itself subject to severe turbulence or adjustments – eg, certain asset classes in the real estate market where some investors plan to find quick solutions to the slow-moving real estate market and troubled situations (eg, increase of vacancy) which makes it difficult to agree an A&E, in particular if they are not willing to put in more equity, leading to foreclosure if investors do not decide to hand back the keys to their creditors.

A year in tumultuous refinancing conditions allows us to highlight key factors of A&E deals so that, as far as possible, they can be a bridge to exit/refinancing and not an endless tunnel!

Anticipation needed to secure the appetite of existing lenders

With tangible options for refinancing effectively limited, borrowers must roll up their sleeves and anticipate a long and complex path to reach an A&E.

Too often, A&E has been chosen at the very end of an initially preferred third-party refinancing process, leaving A&E as the last-chance option, with an overly constrained timeframe. It is advisable to give existing lenders sufficient time to consider an A&E request and, in such a configuration, to identify in the lenders' club those who would be reluctant and then have the opportunity to replace them with any new lender(s) who may have shown an appetite in the context of a third-party senior refinancing or a junior option, it being recalled that a decision to consent to an A&E is generally taken at the unanimity of the lenders. Similarly, if the proposed A&E imposes recourse to junior debt (mezzanine and/or PIK financing) or preferred equity options to meet a senior deleveraging demand (ie, required paydown at A&E opening), such a structuring and its negotiation are difficult to implement in the last months before maturity, in particular when intercreditor principals and security packages shall be agreed (shared and/or lower ranking collateral).

In any case, sponsors must demonstrate viable business plans to get lenders' attention and, in particular, their ability to structure the A&E with a viable exit; as regards bridge to disposal option, ability to run a successful disposal process and then to repay at maturity or to significantly deleverage the extended debt during the bridge is parsed by the lenders, as the third-party refinancing option may remain, as of today, uncertain with the impact of macro-economic headwinds on debt markets and anticipated resets for certain sectors.

As regards real estate financing, a defining factor will be the quality of the underlying assets. Lend-

ers are more focused on financing assets they believe will meet occupiers' changing needs, as well as more stringent sustainability standards.

Key drivers underpinning A&E transactions

In a nutshell, A&E deals offer a mix of higher margin, improved covenant packages, equity injections undertakings and debt paydowns in return for extending maturity runways.

Paydown pitfall

In most cases, sponsors will face a paydown demand forcing them to put additional equity into the transaction; a compromise may consist of negotiating funding of the paydown in several instalments during the life of the bridge provided that no adverse event has occurred (eg, breach of "soft" financial covenant, material deviation of the business plan). Failing to reach an agreement on paydown will undermine any chance of consensual A&E solution and, in some cases, may lead the borrower to seek the assistance of a court-agent in the framework of a pre-insolvency proceeding requested from the president of the commercial court (*mandat ad hoc/procédure de conciliation*).

Monitoring of the business plan

Beyond demonstrating a viable business plan to get an A&E, a monitoring of the "opening" business plan will often be required by the lenders to anticipate any situation of material deviation, shortfall or cost overruns; in certain circumstances, lenders and borrowers will have to agree the terms of a "material deviation" and related baskets/caps, the occurrence of which may require capital commitments from sponsors (secured under personal guarantee) and/or specific deleveraging.

Sacralisation of cash

If lenders are giving relief on financial covenants, they are being more stringent over cash traps and other credit enhancements to provide additional credit support; lenders routinely require a full cash trap subject to specific security as cash collateral or a lenders' controlled account and, as the case may be, a cash-sweep mechanism on agreed milestones or a part thereof, as a new amortisation profile.

Pause of M&A transactions and other capex

In the most complex situations, in the framework of the A&E agreement, lenders may require the restriction or even total suspension of external growth transactions and all non-essential capex to be undertaken by the borrower during the term of the bridge, and then allocate cash for debt service only. This restrictive approach raises a number of questions for groups that have committed, or are due to commit, to decarbonising their assets and complying with the environmental transition, and therefore to financing the corresponding costs.

Hedging strategy to secure the financial costs during the bridge

Lenders require conservative interest risk coverage (tenor matching the maturity of the bridge and notional corresponding to the outstanding loan amount) whilst sponsors are reluctant to pay high premiums to finance risk-free hedging on a short-term bridge and not necessarily in a position to subscribe hedging including a counterparty risk, either because none of their assets is free from collateral or because their existing secured creditors are not willing to enter into an intercreditor agreement with new hedge counterparties.

Key practical tools available for lenders for administering A&E agreements

A&E agreements usually provide for enhanced and assisted monitoring, including, in particular, a more frequent update of the business plan/operating budget and recourse to a third-party agent – ie, project monitor to assist the lenders in order to parse the satisfaction of each milestone, such as review of the business plan assumptions and forecasts (cash balance, potential cost-overruns, impact on supply chain, etc), valuations of the main assets, and review of the sale process and, if any, the relevant offers (letter of intent, memorandum of understanding, etc). A&E agreements also tend to anticipate the exit process (M&A exit, bridge to disposal or new refi process) and therefore include all or part of the following:

- reasonable timetable agreed by the parties and sanctioned by milestones during the life of the bridge;
- pre-approved, third party involved in the exit process (investment bank, debt broker, valuer, etc) with the contractualisation of duty of care arrangements with the lenders to agree the scope of work, due diligences and organising direct delivery of information on the process; and
- ability for lenders to step in if sponsors default in running these processes in particular, through specific rights attached to lenders' golden share or *fiducie* (trust) arrangements, which can be put in place as a condition to the extension.

A&E deals continue to impact terms and documentation

With covenant protections and/or additional credit support demands from lenders, sponsors are keen to be more flexible and accept tighter documents to get A&E, and as a consequence, cov-lite structures tend to dwindle. As regards a collateral package, and beyond obtaining a confirmation from security providers/guarantors that their original transaction security/guarantee obligations extend to the amended debt (as inserted into the amendment and restated agreement or issued by bilateral agreements), lower ranking security over existing collateral may be required when financial conditions of the existing debt are materially increased (considering that the existing secured obligations do not include the effects of these amendments) or personal guarantees may be required in order to secure payment of financial costs and/or void costs during the bridge term.

Impact of forbearance classification for non-performing loans and further prudential backstop – a crucial blip on the lenders' radar

The so-called forbearance classification may result from an amendment to a facility agreement consented when the borrower faces financial difficulties (covenant holiday, postponement of instalments, payment default, etc); as from this amendment, any further difficulty (new default situation or restructuring) triggers increasing capital requirement coverage for the lender (up to 100% of its commitment) from a prudential perspective for that facility which turns as non-performing. The lender's analysis of the A&E request can also be challenging when trying to estimate the impact of the prudential backstop on capital, considering the risk profile of the borrower.

GERMANY

Law and Practice

Contributed by:
Michael Josenhans, Vanessa Steiner, Christina Banz
and Anouschka Zagorski
Freshfields Bruckhaus Deringer

Contents

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The firm would like to thank Adrian Strahm, trainee and Karl Kuhn, trainee, for their contribution to this chapter.

Authors

Michael Josenhans advises on banking and finance matters with a focus on syndicated loan transactions, including corporate finance, acquisition finance, leveraged finance and infrastructure finance. He is a member of Freshfields' global financial sponsors group and global transactions team. For nearly 20 years, he has been advising lenders, sponsors and borrowers throughout Europe and the US on the full range of credit and debt financings. Based on his experience, he provides a deep understanding of complex issues and the rapidly changing market. Numerous corporate clients, sponsors, banks and debt funds rely on his advice for their most important financings or capital restructurings.

Vanessa Steiner is a principal associate in Freshfields' finance practice and advises in banking and finance matters with a particular focus on acquisition financings, leveraged financings and real estate financings. In addition, she has wide experience in advising borrowers and lenders in the context of distressed situations and out-of-court financial restructurings and refinancings. Due to this wide range of experience in different settings, she has a profound understanding of deal terms and recent market developments.

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Freshfields Bruckhaus Deringer

Christina Banz is a principal associate in Freshfields' finance practice specialising in acquisition, leveraged and real estate finance. She is qualified as a solicitor in England and Wales as well as a German lawyer (Rechtsanwältin). Christina has extensive experience advising on growth debt, direct lending, syndicated loan transactions and English law governed finance transactions. She regularly advises lenders, sponsors and borrowers on the full range of credit and debt financings and has a deep understanding of market trends and deal complexities.

Anouschka Zagorski is a member of Freshfields' global transactions group and the head of the English law finance team in Vienna with a special focus on the CEE region. Anouschka is qualified as a solicitor in England and Wales as well as a German lawyer. Her experience includes advising borrowers and financial institutions on project, corporate, real estate, acquisition, asset and ECA finance transactions as well as refinancings and restructurings.

Freshfields Bruckhaus Deringer

Bockenheimer Anlage 44
60322
Frankfurt am Main
Germany

Tel: +49 69273080
Fax: +49 69232664
Email: michael.josenhans@freshfields.com
Web: www.freshfields.com

Freshfields Bruckhaus Deringer

Contributed by: Michael Josenhans, Vanessa Steiner, Christina Banz and Anouschka Zagorski,
Freshfields Bruckhaus Deringer

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Regulatory Environment

In recent years, developments in the German loan market have mainly been shaped by the Capital Requirements Regulation (CRR) and the UCITS V Implementation Act. The CRR (which is based on the Basel III framework) imposes strict capital adequacy requirements on banks and requires them to maintain certain leverage ratios. This heavy regulation has caused regulated lenders to withdraw from certain areas of the lending business, thereby creating a gap. Since the introduction of the UCITS V Implementation Act in March 2016, which amends the German Capital Investment Code (*Kapitalanlagegesetzbuch*) and the German Banking Act (*Kreditwesengesetz*) to allow certain alternative investment funds to originate loans to German borrowers, this gap has gradually been filled by alternative credit providers.

Impact of Recent Economic Cycles

The recent volatility of the German loan market resulting from economic uncertainty, high inflation and rising interest rates has lowered the demand for loans in Q1 and Q2 of 2023 and caused lenders to adopt more risk-averse lending practices. Lenders have placed particular focus on strengthening financial covenant protections and ensuring the financials and business models of potential borrowers are solid.

1.2 Impact of the Ukraine War

Russia's war on Ukraine triggered a wave of dealmaking with investors seeking to offload Russian assets and investments. While the direct claims of German financial intermediaries against debtors in Russia were small, the war in Ukraine had far-reaching effects on German markets. In particular, the war on Ukraine has caused unprecedented energy cost rises, affecting German companies disproportionately given their high reliance on Russian oil and gas. At the same time, this caused a substantial increase of investments and financial demand in the energy transition area.

On the borrower side, those with solid businesses are seeking to refinance existing loans to secure lower rates and better financial terms, where possible. Borrowers with highly impacted businesses, however, often find themselves in lengthy negotiations with lenders to obtain waivers of financial covenants, extensions of existing loans or adjustments of existing terms.

1.3 The High-Yield Market

Economic developments have caused a significant drop in the high-yield bond issuance rate. In 2022, only 13 high yield bond financings were recorded in Europe, marking a 50% decline to the previous year.

Over the years the German high-yield and leveraged loan markets have gradually assimilated their covenant packages and overall documentation terms. Whilst a growing number of high yield bond issuances are secured, there is a noticeable number of typical "covenant lite" provisions in large cap leveraged term loans.

Despite this trend to assimilate loan and high-yield documentation terms, certain differences are worth mentioning. In light of the interest rate volatility, some companies consider issuing fixed rate notes. Loans generally continue to have more extensive undertakings and events of default allowing lenders to demand economic or legal adjustments in case borrowers are seeking amendments or waivers.

1.4 Alternative Credit Providers

As mentioned under **1.1 The Regulatory Environment and Economic Background**, there has been a significant increase in alternative credit providers in the German loan market. Debt funds have traditionally focused on small and mid-cap leveraged buy-outs but are gradually also financing corporate borrowers and offering unitranche solutions for large-cap leveraged acquisitions, thereby taking market share from the syndicated market.

Direct lending by alternative credit providers typically offers certain benefits over traditional bank lending including:

- no syndication risk since the debt is held to maturity;
- flexible and borrower friendly covenants;
- financing at higher leverage multiples; and
- greater execution speed.

1.5 Banking and Finance Techniques

The unitranche offerings have resulted in a high number of super senior bank products, typically revolving credit facilities and related hedging, but more recently also in form of additional term debt. This trend has led to new intercreditor arrangements.

The recent trend to reduced leverage via senior debt and the need for additional leverage in competitive auctions or distressed situations has resulted in PIK HoldCo or preferred equity structures. These products, which are provided by the growing number of very flexible so called "capital solution providers", do not require intercreditor agreements as they are structurally subordinated to the senior loans, but the higher risk triggers a substantial increase in pricing.

1.6 ESG/Sustainability-Linked Lending

ESG and other sustainability linked lending has become a popular component of most lending transactions. Companies and lenders typically agree on bespoke ESG performance indicators that are assessed annually through the delivery of company-produced or objective third-party reports. ESG-ratings have however become less visible over the last years. Depending on whether the targets have been met, the interest rate of the borrower is adjusted. Although such margin adjustments often only range from 1-5 basis points, borrowers and lenders also benefit from the positive image resulting from publicly visible ESG commitments.

2. Authorisation

2.1 Providing Financing to a Company

In Germany granting loans is subject to a banking license. Banking licenses are granted by the *Bundesanstalt für Finanzdienstleistungsaufsicht*, and in case they are combined with a deposit-taking license, the European Central Bank. The license application is a lengthy and burdensome procedure.

The regulatory environment generally does not allow non-banks (institutions that do not hold a banking license) to act as lenders. However, some narrow exemptions apply. As such, non-banks may cooperate with credit institutions in order to be involved in the loan business (so called "fronting-bank model" or "white label model") or may rely in certain circumstances on the reverse-solicitation exemption (see **3.1 Restrictions on Foreign Lenders Providing Loans**). Furthermore, no licence is required for the mere acquisition and holding of loan claims but there is a very fine line distinguishing between the mere "holding" and other actions in

respect of those claims (eg, extensions) which again lead to a license requirement.

In addition, as described in **1.1 The Regulatory Environment and Economic Background**, German investment laws were amended to allow certain EU regulated credit funds to grant loans under very specific circumstances, even if they do not hold a banking license.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

The banking license requirement applies to both domestic and foreign lenders equally. Certain exemptions may apply for EU-institutions which hold a banking license in their home jurisdiction and are supervised by competent authorities in their home jurisdiction within the EU. These institutions may passport their banking license to Germany if they fulfil the relevant requirements.

Generally, the license requirement applies if foreign lenders wish to provide services to customers who are considered as German residents. One exemption to this rule (so called "reverse solicitation") applies in case the customer seeks out the foreign lender explicitly, while the foreign lender does not market or advertise their services to German customers as such.

3.2 Restrictions on Foreign Lenders Receiving Security

Generally, foreign lenders may receive security or guarantees in the same way as domestic lenders. The receipt of real estate security might have certain tax implications for foreign lenders.

3.3 Restrictions and Controls on Foreign Currency Exchange

Germany has not implemented foreign currency controls except reporting obligations in case of incoming or outbound payments regardless of currency. However, banks and payment institutions are required to freeze assets of persons subject to EU sanctions lists. This affects all assets, including funds, regardless of currency. Funds subject to an asset freeze are required to be reported to the competent authorities, which is *Deutsche Bundesbank* in Germany.

3.4 Restrictions on the Borrower's Use of Proceeds

By law, no restrictions on the use of proceeds arise, other than in case of non-compliance with sanctions or other applicable public laws and the financial assistance/capital maintenance requirements described under **5.3 Downstream, Upstream and Cross-Stream Guarantees** and **5.4 Restrictions on the Target**.

3.5 Agent and Trust Concepts

In syndicated financings, it is market standard to implement an agency and security agency concept. The trust concept is not recognised in Germany. To allow the security agent to hold certain types of security, a parallel debt concept will be included in the financing documentation.

3.6 Loan Transfer Mechanisms

Loan claims can be transferred to a new lender by way of a transfer of rights and claims (*Vertragsübernahme*) or by way of an assignment of claims (*Abtretung*).

Transfer of Rights and Claims

The usual way to trade out of and into a syndicated loan is by transferring all rights and claims of an existing lender to a new lender. The new lender does not only assume the right to demand

principal and interest from the borrower but also assumes funding commitments and other obligations of a lender.

Assignment of Claims

In situations in which no more obligations remain on the part of the lender (eg, in the case of non-performing loans) loan claims are usually assigned from the existing lender to the new creditor.

Transfer of Security

In both scenarios, certain security (so called "accessory" security, in particular pledges and mortgages) will by law transfer together with the secured claim. A novation of loan claims should therefore be avoided. In respect of other security (the "non-accessory" security, in particular security transfers, security assignments and land charges), the existing and the new lender would need to expressly transfer the security to the new lender and, in some cases, certain actions from the security grantor could be required. To avoid this, such security is granted only to the security agent in order to secure the parallel obligations of the debtor towards the security agent, and therefore does not need to be transferred.

3.7 Debt Buy-Back

A debt buyback by the borrower or the sponsor is often contractually permitted but accompanied by a disenfranchisement of the borrower or sponsor in such case, meaning that, amongst others, they cannot participate (and are not counted) in any decision-making by the lenders. Sponsors need to consider a potential equitable subordination based on statutory law. Borrowers also need to keep in mind potential tax consequences.

3.8 Public Acquisition Finance

The acquisition of a German public company requires the inclusion of a certain funds concept in the financing documentation because by law the purchaser is required to prove that it will have the required funds available at the time the public offer is made. The financing is not published but only reviewed by an intermediary (a recognised financial institution) which confirms the certain availability of the funds as required by law. For that purpose, strategic buyers will usually already agree long-form documentation while sponsors will in most cases agree on a term sheet and a precedent for the long-form documentation from a previous transaction (sometimes accompanied by an interim loan agreement as a fundable document).

3.9 Recent Legal and Commercial Developments

Pre-insolvency Restructurings

Since 1 January 2021, German legislation has established a comprehensive legal framework for voluntary out-of-court restructurings (for details, see **7.4 Rescue or Reorganisation Procedures Other Than Insolvency**). As a result, certain provisions of financing agreements have become subject to increased negotiations but such renegotiations need to be closely observed in line with the law. Certain lenders, for example, intended to include StaRUG proceedings as an event of default even though such an event of default provision would by void by law.

Sanctions

The Ukraine war and sanctions imposed in connection therewith have recently drawn close attention to the sanctions clauses in new financing agreements. In most cases it turned out, however, that the previous market standard of broad and flexible sanctions provisions was suf-

ficient to cater for this increased awareness and did not require (many) changes.

Bail-In

Credit agreements often include contractual recognition clauses that acknowledge the potential application of bail-in powers by resolution authorities. These clauses are intended to facilitate the smooth implementation of bail-in measures and are required in certain circumstances by regulations like the Bank Recovery and Resolution Directive.

3.10 Usury Laws

In respect of a loan governed by German law, the parties may not agree upfront to compound interest (ie, interest may not be charged on interest) (section 248(1) BGB) but can do so once the interest is accrued (ie, PIK toggle arrangements are possible). In case of unpaid interest, default interest may therefore not be applied. However, the same result is reached by agreeing on the obligation to pay lump sum damages (*pauschalierter Schadensersatz*) in the same amount.

3.11 Disclosure Requirements

In general, financing agreements do not need to be publicly disclosed. In IPOs and bond offerings, summaries of the underlying financial arrangements may need to be published.

Separately, certain disclosure requirements exist due to German banking regulations. Amongst others, financial institutions need to notify the German Central Bank of loans with a volume of EUR 1 million or more (large exposures) together with certain key information on the borrower.

4. Tax

4.1 Withholding Tax

Whether payments of principal, interest or other payments made to lenders are subject to withholding tax depends on the structure and financing in question. The "typical" financing agreement usually triggers no withholding tax. But there are a number of important exceptions, like eg, relating to profit-related payments and certain hybrid arrangements. Also, interest secured by German real estate may trigger a domestic limited tax liability.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Besides withholding tax and limited tax liability aspects (as noted in **4.1 Withholding Tax**), lenders are usually not suffering taxes from lending into Germany. In particular, Germany levies no stamp duty, and net wealth tax is not levied either. VAT may become a relevant aspect in Germany and the EU, but mostly, a VAT exemption applies.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

From a tax perspective, it is important that the lender is not associated with a country in a tax haven jurisdiction. Rather, it is advisable for a lender and beneficial owner of the loan to be tax resident in a tax treaty jurisdiction having a favourable double tax treaty with Germany. This would give the lender the typical tax protection of a Qualifying Lender.

5. Guarantees and Security

5.1 Assets and Forms of Security

A comprehensive collateral package will typically comprise collateral over all of the borrower's

and/or guarantors' assets to the extent the cost benefit ratio justifies it.

Most security agreements have standard terms, leaving little room for negotiation. With few exceptions (mentioned below), security agreements can be executed by simple exchange of signatures (electronic, if agreed between the parties).

Shares/Interests/Stocks

Pledge agreements over shares in German limited liability companies (contrary to pledge agreements over interests in partnerships and over stock in corporations) need to be notarised which incurs high costs. The notarisation is usually attended by the legal advisors of each party based on a power of attorney, possibly requiring certification and legalisation depending on the jurisdiction of the represented party.

The perfection of a pledge requires that the relevant pledged entity is notified of such pledge (implemented either by the relevant pledged entity becoming a party to the agreement for the purpose of such notification or by requiring notification to be sent and evidenced within a certain time period (eg, five business days)). In the case of certified stocks, the stock certificates need to be handed over or a substitute of such handover needs to occur. Sometimes, stock certificates need to be endorsed.

Bank Accounts

In correct legal terms, it is not the account as such that is pledged but the rights and claims which the account holder from time to time has towards the account bank in connection with the bank account.

The perfection of account pledges requires that the account bank is notified of the pledge (implemented by requiring such notification to be sent and evidenced within a certain time period (eg, five business days)).

Moveable Assets

Security transfer agreements require the inclusion of certain details on the location or the identity of the assets and potential rights of third parties (eg, landlords, suppliers or factoring providers). Obtaining the required information on those details from the security provider is a key timing item in this respect.

No perfection requirements exist. However, the transferred assets need to be clearly determinable (*bestimmbar*) by an independent third party. Therefore, close attention needs to be paid to a sufficiently detailed description of the location of the transferred assets or, if necessary, other features which set the transferred assets apart from others (eg, by way of labelling the transferred assets).

IP

IP rights can be assigned or pledged for security, depending on the exact type of IP and its registration. Security rights over IP do not need to but should be registered with the competent registry to protect the lenders' interests.

Note that electronic signatures are not sufficient in the event that the IP includes trademarks registered with the European Union Intellectual Property Office (EUIPO) but in such case actual wet-ink signatures need to be exchanged.

Receivables

Security assignment agreements need special attention in case of other/previous assignments of receivables by the assignor, eg, to a factoring provider. Obtaining the required information from the assignor is a key timing item.

A notification of the debtor of the assigned receivable is not required to perfect the security. However, prior to receipt of a notification the debtor can effectively settle the receivable by way of payment to the assignor. Notifications are therefore common in respect of intra-group receivables and receivables towards professional parties (eg, insurances or report providers) but not in respect of customers.

Real Estate

Security over immoveable assets is provided by way of land charges or mortgages. The land charge or mortgage itself is a standard document only containing a formal description of the security right to be established. Therefore, a related security purpose agreement needs to be concluded which includes all other provisions, such as the security purpose and enforcement triggers.

The land charge or mortgage itself needs to be notarised, resulting in additional costs depending on the amount of the land charge or mortgage. Further costs arise for the registration with the land registry.

Land charges and mortgages can be certified or uncertified. In the case of an uncertified land charge or mortgage, the security only becomes valid upon its entry into the land registry.

5.2 Floating Charges and/or Similar Security Interests

A floating charge typically describes an instrument which creates security over non-constant assets changing in quantity and quality. German law however requires that a security interest must relate to determinable assets such that these assets are identifiable by a third person familiar with the agreement between the security provider and the security taker. A floating charge would not be compatible with these requirements.

In a similar way, however, German security interests usually cover all existing and future assets of a certain type (which is possible for all of the security types mentioned under **5.1 Assets and Forms of Security** except for land charges/mortgages).

5.3 Downstream, Upstream and Cross-Stream Guarantees

It is generally possible under German law for any entity to provide downstream, upstream and cross-stream guarantees or security.

However, if the guarantee/security provider is a German limited liability company or a limited partnership with a limited liability company as its general partner, by law upstream and cross-stream guarantees/security cannot be provided, or may result in personal and criminal liability for the management directors, to the extent the granting or enforcement of such guarantee/security would lead to a breach of capital maintenance rules (*Kapitalerhaltungsregeln*). The capital maintenance rules prohibit the direct and indirect repayment (such term to include payments pursuant to guarantees or security in favour of obligations of a direct or indirect shareholder) of registered share capital of a German limited liability company to its shareholders. Accordingly, by way of so-called “limitation language” in the respective guarantee/security document, enforcement of up- and cross-stream security will be limited, subject to certain exceptions, if and to the extent that payments under the guarantee or enforcement of the security would directly or indirectly cause the net assets (*Reinvermögen*) of the guarantee/security provider (or, in case of a partnership, the net assets of the respective general partner) to fall below

the amount of its respective registered share capital and, hence, create a personal or criminal liabilities for the management directors.

5.4 Restrictions on the Target

The granting of guarantees, securities or financial assistance is not generally prohibited under German law but is subject to certain restrictions, depending on the legal form of the target, to the extent it qualifies as a payment to the shareholders of the target.

Restrictions for Limited Liability Companies and Limited Partnerships

If the target is a limited liability company or a limited partnership with a general partner that is a limited liability company the granting of security or guarantees is subject to the capital maintenance rules set out in **5.3 Downstream, Upstream and Cross-Stream Guarantees**.

Restrictions for Stock Corporations

If the target is a stock corporation (*Aktiengesellschaft*), capital maintenance rules provided in the German stock corporation act (*Aktiengesetz*) generally strictly prohibit payments to shareholders which qualify as a return of capital, unless a fully recoverable repayment claim against the shareholder exists.

Solutions

There is no white-wash procedure in Germany but the following procedures are usually implemented to avoid the legal consequences that may be caused by a breach of capital maintenance rules:

- inclusion of a so-called "limitation language" in the financing documentation (see **5.3 Downstream, Upstream and Cross-Stream Guarantees**);
- a so called "debt push-down", ie, an assumption of the debt by the target company;
- a merger (*Verschmelzung*) of the target with the acquisition vehicle; or
- the conclusion of a domination and/or profit and loss transfer agreement (*Beherrschungs- und/oder Ergebnisabführungsvertrag*) between the target and its shareholder(s).

5.5 Other Restrictions

The articles of association of entities to be pledged can often include provisions requiring the approval of all shareholders for pledges and/or a sale of any shares (*Vinkulierungsklausel*). In such case, shareholder consent for the pledge and for a potential future enforcement of such pledge should be obtained. Ideally the deletion of such provision is requested and implemented prior to, or at least shortly after, the execution of the pledge agreement. Other restrictions are uncommon but could be included in the articles of association which therefore need to be reviewed.

5.6 Release of Typical Forms of Security

All types of security mentioned under **5.1 Assets and Forms of Security** can be released by way of a release agreement which can be executed by simple signature (ie, no notarisation is required in respect of the notarised security rights).

The release of a land charge/mortgage needs to be entered into the land registry in order to become effective. All other security rights cease to exist at the time agreed in the release agreement. The release of the pledges and assignments are usually (but do not need to be) notified to the relevant debtors (if they have also been notified of the pledge or assignment).

5.7 Rules Governing the Priority of Competing Security Interests

Certain security interests (in particular security transfers of moveable assets and assignments of receivables) can only be established once and can therefore only exist in one rank. It can, however, be ensured that the proceeds of such security are applied in a different order to groups of creditors by providing the security to a security agent and contractually agreeing on the order of application, for example in an intercreditor agreement.

Security interests over shares/interests/stocks, bank accounts and land can be provided multiple times in different ranks. Such security interests will rank in the order of their valid establishment (priority rule). Nonetheless, in non-distressed financings, usually only one rank of security is established and the order of application is agreed in an intercreditor agreement, as described above. In deviation thereof, in scenarios in which different secured claims face different insolvency clawback rights, it is common to provide individual, different ranking security rights to different creditor groups.

5.8 Priming Liens

There are two types of security existing by law which usually rank prior to the contractual security rights of lenders:

Pledge by the Account Bank

Account banks usually have a right of pledge over the accounts opened with them based on their general terms and conditions for any claims arising against the pledgor in connection with the account. Account pledge agreements therefore usually request the pledgor to undertake reasonable efforts that the account bank waives or subordinates such pledge. A strict requirement for such waiver or subordination is usually not included given the limited scope of the secured obligations under such pledge pursuant to the general terms and conditions.

Landlords' Right to Moveable Assets on Leased Premises

A landlord of leased premises has a statutory right of pledge over the lessee's assets brought onto the premises for any claims arising in connection with the lease. Given the limited scope of the secured obligations under such pledge it is unusual for a requirement to be included that such pledge needs to be waived. However, in recent transactions we have sometimes seen the requirement for the lessee to regularly provide proof of rent payments in order for lenders to be able to assess the risk associated with the prior ranking pledge of the landlord on a regular basis.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

By law or pursuant to the relevant security agreement, the enforcement of German collateral is only possible if and once the secured claims have become due and payable. In many cases, security agreements contain (additional) conditions, requiring an event of default to have occurred and be continuing and/or the loan having been accelerated. However, certain pre-enforcement securing steps are sometimes permitted without a due and payable claim as long as an event of default is continuing.

The enforcement by law generally requires the enforcing creditor to obtain an enforcement title in court. This requirement is often either waived (eg, in share pledges) or avoided by immediate submission to foreclosure (eg, in land charge deeds).

The further enforcement procedure depends on the type of security:

- A security assignment over claims is enforced by the secured party collecting any claims from the debtors.
- A surety or guarantee is enforced by seeking a court title for payment against the debtor.
- A share pledge is enforced by way of a public sale (ie, an auction). This is subject to a prior notice period typically limited to five business days. After the secured debt has become enforceable pledgor and pledgee may also agree on a private sale; a forced private sale or appropriation is not permitted.
- An account pledge is enforced by instructing the account bank to pay any amounts standing to the credit of the account to the pledgee.
- Land charges/mortgages are primarily enforced by way of public auction. This process can be expected to take at least 12 months. Where the charged real property generates income, it is also possible to place the property into forced administration and to use the generated income to pay down the secured debt. This is often quicker. In any event, the enforcement of a land charge requires six months' prior notice being given to the debtor.

6.2 Foreign Law and Jurisdiction

In general, parties may contractually agree on the governing law of their agreements. Under the Rome I Regulation (Regulation (EC) No. 593/2008) the parties have in general the right to choose any governing law, even without a specific connection to the case.

Similarly, the parties may contractually agree to submit to a foreign jurisdiction. Depending on which foreign jurisdiction is chosen, this submission will be legally binding in accordance with different applicable regulations, conventions or laws.

A waiver of immunity will generally be upheld by German courts. However, assets that serve a specific public purpose generally benefit from sovereign immunity under German law (section 882a of the German Code of Civil Procedure).

6.3 Foreign Court Judgments

Under the Brussels I Regulation recast (Regulation (EU) No. 1215/2012), judgments in civil and commercial matters delivered within an EU member state are (with very limited reasons for rejection) automatically acknowledged in all EU member states, regardless of whether the judgment is final and binding.

When the fundamental criteria for recognition (or rejection) are governed by an international treaty, German courts will apply those criteria.

In all other cases, the foreign judgment must be both final and binding. According to Section 328 of the Code of Civil Procedure (ZPO), a foreign judgment will be acknowledged in Germany if no grounds for rejection (delineated in Section 328 (1) of the ZPO) are applicable. The party seeking recognition bears the responsibility of proving that the elements required for recognition are present.

6.4 A Foreign Lender's Ability to Enforce Its Rights

A foreign lender can generally enforce its rights in the same way as a domestic lender.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

The court order opening insolvency proceedings imposes an automatic stay on any enforcement actions by unsecured creditors against the company. Unsecured creditors can only enforce their rights within the legal framework of insolvency proceedings, ie, substantially file their claims to the insolvency table with the insolvency officeholder to receive the insolvency dividend (pro rata payment). In practice, the court often imposes such stay even prior to the formal commencement of insolvency proceedings in so-called preliminary insolvency proceedings.

The Insolvency Act does not impose an automatic stay on the enforcement by certain (secured) creditors. Generally speaking, the following rules apply:

- Creditors who can demonstrate that they have ownership (title) in an asset or similar rights in rem or other absolute rights which, therefore, are not part of the insolvency estate (segregation right, *Aussonderungsrecht*) have a claim for restitution of the relevant asset, eg, suppliers with (simple) reservation of title rights (*einfacher Eigentumsvorbehalt*).
- Creditors with security interests in assets forming part of the insolvency estate have a right to separate satisfaction (*Absonderungsrecht*), ie, they may seek preferential satisfaction of their claims from the proceeds of the liquidation of the relevant asset. However, the Insolvency Act provides for specific rules regarding the responsibility and process in relation to the enforcement of such security interests.

7.2 Waterfall of Payments

The proceeds realised by the insolvency officeholder (note the exceptions under **7.1 Impact of Insolvency Processes**) will generally be distributed to the creditors pursuant to the following waterfall:

- Costs of insolvency proceedings and so-called administrative claims (*Masseverbindlichkeiten*), ie, including specifically claims arising from transactions executed by the insolvency officeholder after the commencement of insolvency proceedings;
- Unsecured claims (*Insolvenzforderungen*) pari-passu;
- Subordinated claims (*nachrangige Insolvenzforderungen*), eg, interest accruing after the commencement of insolvency proceedings or certain shareholder loans (eg, by shareholders holding more than 10% of the registered share capital provided they are not part of the management board).

7.3 Length of Insolvency Process and Recoveries

The sale of a company on a going concern basis out of insolvency (asset deal) is typically consummated within three to six months. The completion of the proceedings regarding corporate insolvencies including any litigation, admission of claims, distribution of the insolvency estate, etc, can take several years depending on the size of the company and/or the complexity of the matter. If the insolvent company implements an insolvency plan, the time frame also varies from a few months to several years.

The range of the insolvency dividends distributed in German insolvency proceedings varies widely. The rights of segregation and rights to separate satisfaction are usually not included in insolvency statistics in Germany. These depend

on the value of the collateral in each individual case. For insolvency proceedings commenced in 2011 and concluded by 31 December 2018 the average dividend of unsecured creditors amounted to 6.1% (see German Federal Statistical Office (Destatis), 2020, Reference (Fachserie) 2, series 4.1.1, p. 4).

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

StaRUG

Since 1 January 2021, the Stabilisation and Restructuring Act (StaRUG) (implementing the EU Restructuring Directive of 20 June 2019 (Directive (EU) 2019/1023)) provides for a comprehensive legal framework for voluntary out-of-court restructurings.

In principle, a debtor with its centre of main interest in Germany has access to StaRUG proceedings if it faces imminent illiquidity (*drohende Zahlungsunfähigkeit*) but not yet illiquidity (cash-flow insolvency, *Zahlungsunfähigkeit*) or over-indebtedness (balance sheet insolvency, *Überschuldung*) (each as defined in the German Insolvency Act).

StaRUG then allows the debtor to implement a financial restructuring and bind all creditors, including classes that do not approve the plan, through a cross-class cram-down. Operational restructuring measures, however, continue to require a consensual agreement of all affected parties (for example, the termination of long-term contracts such as lease agreements is not feasible under StaRUG).

If a new financing is required to implement the restructuring, such financing in principle will be excluded from claw back and lender liability in subsequent insolvency proceedings. However, as these privileges only apply for a limited timeframe until the debtor is sustainably restructured, in practice lenders will continue to rely on a restructuring opinion (S6-Sanierungsgutachten) to reduce risks (see **7.5 Risk Areas for Lenders**).

SchVG

The German Bond Act 2009 provides for an out-of-court restructuring procedure in relation to bonds governed by German law. Provided that and to the extent the terms and conditions of the bond provide for the possibility to amend these by way of a bondholders' resolution, the SchVG allows for a wide range of restructuring measures. These include, eg, a waiver of principal and/or interest, deferrals, a debt-for-equity-swap and modifications of the terms and conditions of German bonds. The resolution of bondholders generally requires for major decisions such as waivers or debt-for-equity-swaps a quorum of 50% by value of the bonds in the first bondholders' meeting, and, if the quorum is not met, 25% by value in a second bondholders' meeting. No quorum is required for other decisions. The majorities that must be obtained to approve the resolution for major decisions are 75& of bondholders by value present and voting in the bondholders' meeting and more than 50% for any other decisions (such as the appointment of a joint representative). The bondholders' resolution is subject to appeal within one month. A successful appeal will nullify the resolution.

7.5 Risk Areas for Lenders

Insolvency Claw-Back

Certain pre-commencement transactions are subject to insolvency claw back actions by the insolvency officeholder provided certain conditions are met. Generally speaking, to be subject to claw back, the relevant transaction must have occurred prior to the commencement of insolvency proceedings and must have disad-

vantaged the debtor's creditors (indirect effects being sufficient).

Finance documents therefore typically contain information obligations aimed at providing regular and, in the event of arising difficulties, early visibility of the borrower's financial situation.

Lender Liability

Under German law, if a lender refuses to grant a (new) loan to the distressed company, accelerates its (existing) loans or refuses to waive (partially) its claims, thereby causing the company's insolvency, the lender generally cannot be held liable, as it has no legal obligation to participate in the restructuring or remediation measures of the company. Nonetheless, lenders need to carefully consider the legal implications of their actions for the borrower's directors given the relatively strict personal/criminal insolvency liability regime.

However, liability can, under certain circumstances, be construed on the fact that granting or extending a loan causes or assists the debtor's delay in filing for insolvency. When granting new loans or extending maturities of existing loans to borrowers in distress lenders therefore typically request the issuance of a restructuring opinion pursuant to an industry standard (IDW S6) by independent experts essentially objectively confirming that the borrower can be restructured.

8. Project Finance

8.1 Recent Project Finance Activity

Project finance activity in Europe is spread across many sectors but continues to show a clear tendency towards infrastructure projects. In the near to mid-term, a particular focus will be on infrastructure required for energy transition and transportation.

Energy Transition

Germany's energy transition targets include for renewable energies to make up 60% of the gross final consumption of energy and 80% of the gross electricity consumption by 2050. For this purpose it is estimated that around EUR600 billion of investments will be required amongst others in the areas of energy production, electricity grid expansion, energy storage and electrifying the transport sector.

Transportation

In the 2030 Federal Transport Infrastructure Plan, the German government has identified a EUR270 billion need to renew and expand various federal motorways, railway infrastructure and waterways until 2030, and the current government is strategising substantial allocations for the enhancement and expansion of the rail network following the "Germany Pulse" (*Deutschlandtakt*) framework.

8.2 Public-Private Partnership Transactions

Legal Framework

In Germany, PPPs are usually based on a civil agreement between a public partner and a private entity. The public partner can be the Federal Republic, a federal state or one of its authorities or a local community while the private partner is a legal entity or a joint venture with several entities as shareholders. No specific laws on public-private partnerships have been enacted but general rules of corporate and financing laws and – because of the public aspect of the partnerships – EU and national public procurement rules apply. The PPP Acceleration Act of 2005 (*ÖPP-Beschleunigungsgesetz*) provided for a

number of amendments to existing legislation to facilitate PPPs.

Identification of Possible Projects

At first, the public partner in respect of a project needs to assess the overall justification for a PPP. Federal and state budget laws require the economic efficiency to be substantiated through a detailed economic plan of the project and its comparison with an implementation of the project by way of a "conventional" procurement process. In addition, compliance with EU subsidies law must be ensured.

Preparation Phase

Thereafter, the public partner develops the main project contracts and specifications of the project and determines the project's main aspects such as its term, the project's corporate set-up, equity and financing, a suitable contract model and the required level of public control. The administrative framework of the PPP can require a certain type of structure to retain certain levels of public control over the project.

Award and Negotiations

Once the main terms have been prepared, the public partner finds its private partner through a contract award procedure. According to section 2 of the Procurement Ordinance (*Vergabeverordnung*), the PPP project is subject to a formal award procedure if its volume exceeds a certain threshold whereas budget laws may require a tender even if the project remains below such thresholds. Procurement regulations frequently necessitate a Europe-wide tender and grant the applicant the right to pursue legal remedies before a public procurement tribunal.

Implementation

Once the project has been awarded and the PPP has been finally negotiated and established the implementation of the project commences. During this phase, all laws applicable to the relevant project matter need to be observed.

8.3 Governing Law

Generally, parties are free to agree on the applicable law of the agreements (see **6.2 Foreign Law and Jurisdiction**). However, if the project is or the relevant assets are located in Germany, parties usually prefer German law to govern (all or certain of) the agreements to ensure consistency and enforceability in Germany.

The parties can also agree to submit the contract to arbitration proceedings. Germany is a party to several dispute resolution agreements, including but not limited to the New York Convention, the Energy Charter Treaty of 1964, the Geneva Protocol on Arbitration Clauses of 1923 and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) of 1965.

8.4 Foreign Ownership

Germany generally embraces foreign investments and maintains an open and accommodating stance, imposing minimal restrictions on such investments. In general, no restrictions exist on foreign entities owning real property or other resources in Germany. However, in certain exceptional cases, the government needs to be notified and may veto a transaction.

8.5 Structuring Deals

Project finance transactions are commonly structured as non-recourse financings in which the project company is set up as a special purpose vehicle. The financing is fully repaid through the free cashflow of the project company; sponsor guarantees are uncommon.

The project company will most commonly be a limited partnership (*Kommanditgesellschaft*) in which a limited liability company (*Gesellschaft mit beschränkter Haftung*) (GmbH) holds the position of the general partner (GmbH & Co KG). Equity contributions are typically made by the sponsors as limited partners. The shares in the general partner are typically held by the sponsors pro rata to their shares as limited partners. Alternatively, they can be held by the limited partnership itself (*Einheitsgesellschaft*), which facilitates transferability.

Further structuring will depend on the risk allocation between the parties and subject to all German and EU laws and regulations applicable to the sponsors, the lending entities, the project company and the sector.

8.6 Common Financing Sources and Typical Structures

Financing is usually provided by way of a (senior) bank financing to the project company and subordinated shareholder loans. In certain structures, mezzanine or subordindated holdco (PIK) financing may be taken up by the project company's holding company.

Alternative debt providers play an increasingly important role with debt funds funding into German project financings by way of subordinated or mezzanine financing, bridge loans refinanced upon the conclusion of senior financing, as a way of refinancing the equity made available upfront and, in select cases, even as senior lender.

The mix of available financing instruments is sometimes accompanied by project bonds or other sources of financings, such as export credit agency financings.

8.7 Natural Resources

Ownership of land as such does not require a license and resources found on the property generally belong to the owner. Nonetheless, the extraction of metals, salt, and similar resources requires authorisation from the mining authority. Likewise, the establishment and operation of energy pipelines, electrical transmission lines and related infrastructure must receive approval from the relevant authority of the relevant federal state in which the assets are located. Usually, the granted permit will be time-limited and subject to a number of conditions such as compliance with environmental, health and safety laws. Royalties, taxes and other fees payable in connection with the extraction of natural resources vary depending on the type of natural resource. There are no general limitations, charges, or taxes associated with the exportation of natural resources. However, specific regulations may be applicable to particular exports contingent on the nature of the natural resource in question.

8.8 Environmental, Health and Safety Laws

As a general rule, projects with the potential to cause adverse environmental impacts or pose hazards to the environment or individuals typically necessitate a permit, typically obtained from the relevant local authority. The execution of such projects is subject to various regulations, including occupational health and safety guidelines, which are overseen by multiple authorities.

The authority over specific projects varies based on the sector in question. For instance, regulatory oversight for projects in the oil and gas sector rests with regional authorities. The process for oil and gas exploitation in Germany follows a two-step approach, requiring an initial permit for exploration and a separate one for actual extraction. In the case of offshore wind farms, an oper-

ating permit issued by the Federal Maritime and Hydrographic Agency of Germany is mandatory, while the energy grid is managed by the Federal Network Agency (*Bundesnetzagentur*).

Trends and Developments

Contributed by:
Thomas Ingenhoven and Alexander Lang
Milbank LLP

Milbank LLP is a leading international law firm handling complex high-profile cases and business transactions for clients around the world. Founded in New York over 150 years ago, Milbank has further offices in Beijing, Frankfurt, Hong Kong, London, Los Angeles, Munich, São Paulo, Seoul, Singapore, Tokyo and Washington, DC. Milbank's international presence and experience are particular strengths for challenging, multi-jurisdictional transactions, including financings for cross-border acquisitions and global, multi-currency credit facilities for businesses operating in many countries. The German banking and finance practice represents underwriters, bank and debt fund lenders, private equity sponsors, strategic investors, issuers and borrowers in a broad array of financings, including general syndicated lending, infrastructure finance and acquisition financings, in particular complex cross-border LBO and Term Loan B-financings, bank/bond financings combining syndicated loan facilities and debt capital market products, including cross-over products such as hybrid bonds and German Schuldschein-loans. The team also specialises in non-bank lending structures, PIK facilities, preferred equity deals and other subordinated financing instruments.

Authors

Thomas Ingenhoven is a member of Milbank's banking and leveraged finance group. He specialises in acquisition finance, syndicated lending and asset finance under German and English law. He advises lenders, sponsors and corporate borrowers on all aspects of acquisition finance and leveraged buyouts, financial restructurings, general syndicated lending and asset finance transactions. His recent representations include advising lenders and sponsors/borrowers on a large number of German and international leveraged buyouts, a range of investment grade and sub-investment grade (crossover) corporate credit facilities, syndicated promissory notes for German and foreign issuers, asset-based financings, unitranche and super senior credit facilities, credit facilities embedded in multi-layered capital structures including second lien, PIK facilities, Term Loan B-financings and capital market instruments.

Alexander Lang is a member of Milbank's banking and leveraged finance group. He specialises in acquisition finance, syndicated and general bank lending. He advises leading financial institutions, private equity investors and corporate institutions on domestic as well as cross-border transactions, including leveraged buyouts, secured and unsecured bank lending and syndicated loans. Other areas of expertise include infrastructure finance, asset finance and restructuring. His recent representations include advising lenders and sponsors/borrowers on a large number of German and international leveraged buyouts, a range of investment grade and sub-investment grade, unitranche and super senior credit facilities, credit facilities embedded in multi-layered capital structures including second lien, PIK facilities, Term Loan B- financings and capital market instruments.

Millbank LLP

Neue Mainzer Straße 74
60311
Frankfurt am Main
Germany

Tel: +49 69 71914 3400
Email: tingenhoven@milbank.com
Web: www.milbank.com

Milbank

Banking and Finance in Germany: an Introduction

Political and macroeconomic turmoil continues to affect market activity in 2023. The highest interest rates since the global financial crisis have led to a further decrease in debt raisings to fund leverage buyouts and amend and extend transactions dominate the market.

While equity capital markets activity in the US seems to recover, in Europe it has shrunk compared to the first three quarters of 2022.

Demand for liquidity is caused by exploding energy costs and increased interest rates as well as looming maturity walls. Still, this demand is yet to be reflected in the documentation.

Amend and Extend

The current market environment and looming debt maturity wall have encouraged several market participants to approach the lending market with amend and extend (A&E) proposals for existing loans in lieu of full refinancings. Most of them have approached their lenders with an A&E request accompanied by a term sheet including few other amendment requests. Lenders' willingness to accept further improvements in the documentation in an A&E scenario is very limited. If the required majority within the lending consortium is reached, the maturity extension is documented in an amendment and restatement agreement.

If a lender fails to respond within a specified time, that lender's commitment is discounted for the purpose of determining whether the necessary lender majority has been reached ("snooze-you-lose").

Lenders rejecting their consent to an amendment request, which requires a consent level greater than majority lenders' consent (including structural adjustments), "yank-a-bank" provisions can entitle a borrower to replace such non-consenting lender with an existing or a new lender if consent of the majority lenders has been obtained and the existing or incoming lender is willing to assume the non-consenting lender's commitment.

Notably, in many European loan documents, an extension of a loan term is qualified as a so-called structural adjustment, requiring not just the consent of the majority of lenders but also of each lender participating in the affected facility. In that case, a non-responding lender cannot be forced into a term extension but can be forced to leave the consortium and be replaced by an existing or incoming lender as set out above.

Calculation of (Pro Forma) EBITDA

As in previous years, lenders remain focused on the calculation of financial ratios, in particular EBITDA adjustments effected through adding back certain EBITDA-reducing items to the pro forma adjusted EBITDA. Pro forma adjusted EBITDA is used in the loan documentation to test a borrower's leverage ratio, which in turn is relevant for determining whether any financial covenants under the facility are breached and whether additional (incremental) debt can be incurred (as further discussed in the next paragraph). In deals including an EBITDA-based grower basket mechanism, the pro forma adjusted EBITDA may also be used to calculate the permitted baskets, determining, for example, the permission to incur further debt, dispose of assets or provide security for further financing.

Add-backs for projected cost savings and synergies are typically capped at 15 to 25% of the pro forma adjusted EBITDA. Confirmation by an auditor or other third-party financial expert

of synergies exceeding 10 to 15% of the pro forma adjusted EBITDA is often prerequisite. Add-backs to revenues – even if capped – remain subject to strong lender push back. The forward- looking period in European deals is predominantly set at 18 months.

Another way of adjusting EBITDA is to add-back so-called exceptional items. These are unusual, non-recurring or extraordinary gains, expenses or losses that are added back to (the reported) EBITDA. Although in most deals such exceptional items are uncapped, we currently see lenders requesting that such adjustments are capped, or the scope of such extraordinary items is limited. A cap on exceptional items often takes the form of an aggregate cap together with synergy add-back so that the total amount of adjustments for exceptional items or synergies does not exceed a pre-agreed level, often set at the 15 to 25% cap for synergies.

Additional Debt Capacity

Additional debt capacity is a key consideration for borrowers to ensure sufficient liquidity in a market environment made volatile by inflation and high interest rates. Borrowers can raise additional debt by way of an incremental facility within the loan documentation, provided either by existing lenders or new incoming lenders who accede to the financing documentation (and consequently benefit from any transaction security securing the primary loan). Additional debt incurrence is mostly limited by way of a ratio cap instead of a hard cap. In European loan documents, a cap based on the net leverage ratio is predominant in limiting additional debt incurrence. The leverage ratio relevant for determining the cap must typically neither exceed the borrower's (consolidated) opening leverage (at the time of closing) nor, moving forward, level of the currently applicable financial covenant profile.

Furthermore, borrowers can incur additional debt under permitted financial indebtedness baskets. These are not secured by the security provided for the primary loan but can be secured by other assets constituting permitted security.

One potential source of liquidity is factoring, whether on a recourse or non- recourse basis. Factoring on a recourse basis is capped under the loan agreement (contrary to non-recourse factoring which very often is permitted without a cap given that it is not considered to constitute debt). In recent deals in which trade receivables were not within the transaction security package, factoring has become an important instrument to raise liquidity.

Finally, a general basket for local facilities, accompanied by a general permitted security basket, can also improve a borrower's liquidity position.

PIK Toggle

So-called "PIK toggles" allow a borrower to pay due or accrued interest in kind instead of in cash. They are a useful feature to enhance a borrower's liquidity. Banks have not been seen to provide this option. By contrast, private debt funds often allow borrowers to elect that a portion of due or accrued interest is not payable in cash but instead capitalised and compounded with the loan to which it relates. The number of exercises of option to capitalise interest is limited and borrowers are still required to pay a certain minimum amount of interest in cash on each interest payment date. In return, lenders offering a PIK toggle benefit from a margin premium with regard to the capitalised portion of interest (which premium is typically also capi-

talised and not paid in cash). An alternative for banks or funds unable to allow interest to be capitalised due to their internal policy or guidelines is to expand the purpose of a (committed) acquisition or capex facility to encompass the financing of payments of interest.

Lenders offering a PIK toggle under German law should be aware of certain legal restrictions on the capitalization of interest. German law requires that interest is not capitalised prior to the last day of the applicable interest period. Thus, a PIK toggle must only be exercised once the interest has actually accrued and not in advance.

New Deal Activity and Outlook

The banking and finance environment in Germany remains difficult. In particular, no end to the political turmoil is in sight. Also, high energy costs still affect businesses. However, there are indications that better times are ahead.

The equity capital market is recovering, and a number of IPOs have or will come into the market, and a few others are in preparation. But the market is still fragile.

Inflation is still not where it should be, but interest rates might have peaked. There are some indicators that the focus might shift from further increasing interest rates toward keeping them at the current level. High interest rates will continue to impact the valuation of assets but allow market participants to assess their value better, which can in turn be reflected in the valuation of the relevant asset – on both the sell and the buy side.

IRELAND

Law and Practice

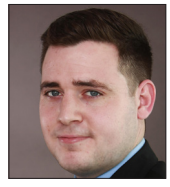
Contributed by:
David O'Mahony and Conor Lynch
Matheson LLP

Contents

Matheson LLP has more than 50 lawyers in its finance and capital markets team and advises financial institutions and corporations involved in arranging and executing all forms of finance and capital markets transactions in Ireland. The team advises major Irish banks and financial institutions, corporate borrowers and many of the world's leading international banks, investment managers and investment funds, securities and derivatives trading houses, broker dealers, insurance companies, alternative finance providers, supranational organisations, rating agencies, trustees and other financial services firms in relation to their lending, borrowing, finance and capital markets transactions and arrangements. Matheson is actively involved in, and holds representative positions on, numerous industry organisations and trade bodies and has been instrumental in proposing, drafting and advising on many changes to finance and capital markets legislation in Ireland.

Authors

David O'Mahony is a partner in the finance and capital markets department of Matheson LLP. He has extensive experience advising on secured and unsecured lending transactions, bilateral loans, real estate finance, project finance, syndicated loans, debt restructuring, template loan product documents, receivables finance and fund finance. David currently acts for several leading Irish and international banks and financial institutions, non-bank lenders and a wide range of corporate borrowers.



Conor Lynch is a senior associate in the finance and capital markets department of Matheson LLP. Conor has experience advising several leading domestic and international banks, financial institutions and corporate borrowers on bilateral and syndicated facilities, secured lending transactions, senior and mezzanine financing transactions, project finance, lending to regulated funds and debt restructuring.

Matheson LLP

70 Sir John Rogerson's Quay
Dublin 2
Ireland

Tel: +353 1 232 2872
Fax: +353 1 232 3333
Email: david.omahony@matheson.com
Web: www.matheson.com

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Lending activity has continued to operate at a high level across all industries this year. The Irish lending market is comprised of banks and non-bank lenders, which vary from funds to smaller private equity houses. There has been continued consolidation in the domestic lending market with the departure of KBC and Ulster Bank from Ireland. There is also more activity from new entrants from outside of Ireland.

The war in Ukraine and high levels of inflation saw a large number of companies seek to increase their working capital lines to ensure that they had sufficient liquidity to withstand the higher prices that were seen across the board during the course of 2022.

Following high levels of activity relating to real estate finance in 2021, 2022 remained quite buoyant for real estate financings (although activity did decrease slightly in the latter part of the year). 2023 has seen a decrease in real estate finance activity as interest rates continue to rise and overall demand for commercial real estate decreases. However, the real estate market in Ireland is resilient and it is expected that activity will increase towards the end of 2023.

M&A remained strong in 2022 (but has been sluggish so far in 2023) although such activity is being funded less by debt finance, which is an obvious impact of the higher interest rate environment. Fund finance and project finance activity remains quite strong.

As the impact of Brexit continues to be monitored, it is clear that no significant changes have been caused in the Irish loan market with Ireland still having close economic and political ties to the United Kingdom. Positive consequences of Brexit for the Irish loan market include a noticeable increase in Irish law being the governing law for international finance transactions and, in particular, in relation to project financing.

1.2 Impact of the Ukraine War

The Ukraine war has had a similar impact for Ireland as other countries within the EU in relation to a dramatic increase in electricity prices. These increases and political pressure have forced the government into providing financial support to businesses and consumers by way of a credit against electricity bills.

The Ukraine war has had a very significant impact for Ireland in the agrifood sector, which has seen the increase in electricity prices being coupled with higher input costs in relation to grain and fertilisers. Many large Irish agrifood companies sought to increase their working capital facilities over the course of 2022 to deal with the impact of higher costs.

1.3 The High-Yield Market

Irish entities in various industry sectors may be involved in high-yield bond transactions, often as borrowers and guarantors, and in certain circumstances as high-yield bond issuers.

Irish incorporated special purpose vehicles (SPVs), often referred to as "Section 110 companies", are normally used as high-yield bond issuers in certain European high-yield transactions, often to avoid covenant breaches or local law restrictions on guarantees of securities. Section 110 companies are named as such because Section 110 of the Taxes Consolidation Act 1997 allows for special tax treatment for "qualifying companies".

Favourable tax laws allow these structures to be, in most cases, tax neutral (with no annual minimum profit or "spread" required at the SPV level) and a "quoted eurobond" exemption. This, together with numerous double taxation treaties, allows interest on securities to be paid gross. A minimal share capital requirement makes incorporating an Irish SPV an easy and attractive process.

European High-Yield Bonds

European high-yield bonds are normally marketed as private placements, primarily to attract US investor interest as well as participation from European investors. These transactions are usually led through London or the USA, and New York law or English law are typically the governing laws of such transactions. The authors are unaware of any high-yield bonds which have been governed by Irish law to date.

Whereas lenders in loan financings would tend to be traditional banks and other financial institutions, investors in high-yield bonds would typically be institutional investors (including investment banks, insurance companies, pension funds, hedge funds, investment managers and mutual funds) looking for higher rates of return through more aggressive lending practices.

1.4 Alternative Credit Providers

There has been a continued increase in the prominence of alternative credit providers in the Irish market since the financial crisis. Non-bank lending is currently concentrated in the buy-to-let and refinance segments of the market, when compared to lending by retail banks. The alternative credit providers group includes a diverse collection of direct lenders, debt funds and debt arms of hedge funds and buyout houses. This allows borrowers to be more selective when choosing lenders and results in greater liquidity as well as more competitive pricing and terms.

1.5 Banking and Finance Techniques

In recent years, there has been a continued growth in the asset-based lending market. This has been particularly noticeable in the commercial and residential property development industries, especially in Dublin. Asset-based lending has benefited both lenders and borrowers through reduced credit risk and competitive pricing.

Irish-incorporated real estate investment trusts (REITs) can be listed on the main market of a recognised stock exchange of any EU member state, which has had the effect of attracting fresh capital into the Irish property market. There has also been a recent trend of advancing unsecured debt to REITs, which improves their balance sheet strength. To accommodate this, lenders have been making use of covenant packages which limit the amount of secured debt a REIT can issue.

After the economic crash in 2008, there was a noticeable increase in the use in invoice discounting as a financing tool. The Irish Asset and Invoice Finance Association anticipates that Irish businesses will repeat this trend to deal with any cash flow issues.

1.6 ESG/Sustainability-Linked Lending

In the past year, Ireland has continued its shift towards increased ESG reporting requirements for companies, and the popularity of green loans and sustainability-linked loans has continued to rise.

ESG Reporting

The current regime for ESG reporting is based on the Corporate Sustainability Reporting Directive (CSRD).

The CSRD seeks to standardise and simplify sustainability reporting for companies, creating one format that meets the needs of EU regulators, investors and other stakeholders. Though the scope of companies subject to ESG reporting is increased by the CSRD, this type of reporting will still not apply to smaller, non-listed companies. However, given the recent expansion of the application of ESG requirements, as well as the fact that investors are increasingly looking towards a company's performance against ESG performance metrics when evaluating it, it looks as though many entities not yet subject to reporting under CSRD are expected to take pre-emptive steps by making firm commitments to their ESG practices and policies.

Green Loans and Sustainability-Linked Loans

The year has seen a continuing increase in relation to the volume of green finance and sustainability-linked loans, as banks continue to deliver on their core values and sustainability commitments.

Green loans have primarily been made available in the property finance and development finance space together with individual large corporates where they have specific green projects as part of their overall ESG strategy.

The availability of green loans and sustainability-linked loans had been limited to the PLC and large corporates, but recently has seen further expansion into the mid-size corporate market, as well as small and medium-size enterprises. Ireland is set to be a key player on the sustainable finance world stage with Sustainable Finance Ireland (SFI) and the publication of its National Sustainable Finance Roadmap in late 2021, setting out its plans to make Ireland a leading sustainable finance centre by 2025.

This is an area that is expected to continue to develop further over the next 12–24 months and it is anticipated that borrowers who have not introduced this concept into their loan agreements will be outliers in the loan market.

The LMA has published draft wording in relation to sustainability-linked loans, which has been largely adopted by market participants with certain transaction specific amendments.

2. Authorisation

2.1 Providing Financing to a Company

The Central Bank of Ireland is responsible for prudential regulation and supervision of credit and financial institutions. Wholesale lending to companies generally does not require authorisation, provided the lender does not take deposits, carries on investment services or provides services to consumers. Traditional banks, those which create securities and fall within the definition of a banking business, are required to hold a banking licence.

A bank authorised in another EEA member state (the home state) can passport its services through establishing a branch in Ireland, or by providing its services in Ireland (the host state) on a cross-border basis.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

At a high level, there are no restrictions on the granting of loans in Ireland by foreign lenders. However, there may be restrictions on loans for certain purposes (eg, mortgage lending) and to certain persons (eg, consumers or SMEs).

3.2 Restrictions on Foreign Lenders Receiving Security

There are no specific restrictions under Irish law on the granting of security or guarantees to foreign lenders.

3.3 Restrictions and Controls on Foreign Currency Exchange

There are no restrictions, controls or other concerns on and regarding foreign currency exchange, save that a person (legal or natural) shall not operate as a Bureau de Change Business in the absence of an authorisation from the Central Bank of Ireland under Part V of the Central Bank Act 1997 (as amended from time to time).

3.4 Restrictions on the Borrower's Use of Proceeds

Ireland is required to comply with UN and EU sanctions law. In addition, lenders regularly require contractual assurances from borrowers in order to comply with such sanctions law, together with all applicable anti-corruption, anti-money laundering and counter-terrorism laws.

3.5 Agent and Trust Concepts

The agent concept is well recognised and established in Ireland. The role of the agent is governed by the loan documentation.

The concept of a trust is also recognised in Ireland. The security trustee is a trustee of the syndicate members with fiduciary duties to the syndicate members for the duration of the loan contract. The role and rights of the security trustee is governed by the loan documentation and may also be subject to legislative or other public policy considerations.

3.6 Loan Transfer Mechanisms

Secured debt is traded in Ireland, usually by means of assignment, transfer or novation. An assignment of security should be notified to the security provider (or in accordance with the terms of the underlying security document). A transfer or novation can be effected with the security provider as a party to the transfer or novation.

In the case of a transfer or novation, appropriate registrations should be carried out in the Irish Companies Registration Office (CRO) and/or Land Registry and/or Registry of Deeds (as applicable). Typically, Loan Market Association standard documentation is relied on, which contains standard language in relation to novation and transfer.

3.7 Debt Buy-Back

The permissibility of debt buy-back will depend on what is commercially agreed between the lender(s), borrower(s) or sponsor(s), but there is no restriction under Irish law to agree terms relating to the buy-back of debt. However, there could be restrictions contained within the loan agreement in relation to the ability for a borrower or sponsor to buy-back debt.

3.8 Public Acquisition Finance

Certain funds provisions in credit agreements originate from the requirements of the Irish Takeover Rules which govern the takeover of any

public limited company incorporated in Ireland. The Irish Takeover Rules require that a bidder must announce a bid only after ensuring that it can fulfil in full any cash consideration (if any is offered) and after taking all reasonable measures to secure the implementation of any other type of consideration. A financial adviser also must stand behind any bid and confirm that the relevant bidder has certain funds; ie, that the funding will be available on the completion of the acquisition of the securities to pay the full amount due. This position must be confirmed in the Rule 2.5 Announcement and the offer document.

Certain fund provisions are specifically negotiated for the relevant public acquisition finance transaction and tend not to be standard provisions contained in other acquisition finance transactions. Whether short- or long-form documentation is to be used will normally depend on the credit requirements of the relevant lenders. Although the main provisions of finance documents are set out in the offer document, such details are not required to be publicly filed or registered in Ireland.

3.9 Recent Legal and Commercial Developments

Legal Developments

The effectiveness of contractual automatic crystallisation clauses appears to have been affirmed in a High Court case from November 2020. In Latzur Ltd (in receivership) v Companies Act 2014 [2020] IEHC 592, the High Court held that "there is no rule of law precluding parties to a debenture creating a floating charge agreeing, as a matter of contract, that the floating charge will crystallise on the happening of an event, or a particular step taken by the chargee". It also confirmed that while a crystallised floating charge will de-crystallise during an examinership in order to allow the statutory scheme to operate, once the examinership period of protection ceases without the court having approved proposals for the survival of the company, the charge will re-crystallise once again. It is understood that this case is currently being appealed.

Regulatory Developments

In recent years, there has been a push towards the filing and maintaining of beneficial ownership details for certain entities and arrangements. This is driven by EU anti-money laundering directives that have been transposed into Irish law by way of regulations.

- The Central Register of Beneficial Ownership of Companies and Industrial and Provident Societies was established in June 2019, and requires most Irish companies to file their beneficial ownership details on this central register, which is maintained by the Irish Revenue Commissioners.
- Since June 2020, certain financial vehicles must file their beneficial ownership details with the Central Bank's Central Register of Beneficial Ownership of Irish Collective Asset-management Vehicles, Credit Unions and Unit Trusts.
- More recently, the Irish Revenue Commissioner's Central Register of Beneficial Ownership of Trusts was established in April 2021. Relevant trusts must file their beneficial ownership information within six months of their creation.

Additionally, Russia's invasion of Ukraine has caused a number of significant regulatory developments in Ireland. As a result of Ireland's membership of the EU, all sanctions imposed on Russia by way of EU Regulations are directly effective in Ireland. The Central Bank of Ireland is designated as the competent authority to deal

with suspected breaches of these sanctions which include:

- restrictions on import and export of coal, oil and other goods;
- introducing asset freezes, restricting access to funds and assets of named, high-ranking and wealthy individuals with close links to Russia;
- restrictions on transactions with Russian banks; and
- additional financial transaction restrictions.

3.10 Usury Laws

Protection against excessive interest rates in Ireland is afforded to borrowers and consumers by the Consumer Credit Act 1995, as amended by Section 35 of the Central Bank and Financial Services Authority of Ireland Act 2003.

Lenders should be aware of the treatment of default interest under Irish law. The judgments handed down by the Court of Appeal in July 2018 (Sheehan v Breccia/Flynn and Benray v Breccia) address whether, under Irish law, an obligor's agreement to pay default interest was unenforceable because it was not a "genuine pre-estimate of loss caused by such default". Essentially, the Court held that if a default interest provision is contained in the lender's standard terms and conditions, it will be considered to be a penalty and therefore unenforceable. It would, therefore, be pragmatic for lenders to include a tailored, negotiated term in the credit agreement relating to default interest (rather than relying on the default interest provisions contained in the standard terms and conditions) in order to give the lender the best chance of such provisions not being considered a penalty.

3.11 Disclosure Requirements

There are no rules or laws regarding disclosure of certain financial contracts. There is an obligation on certain financial institutions to disclose loans to certain borrowers where the amount of such relevant loan is EUR500 and above.

4. Tax

4.1 Withholding Tax

A company making a payment of yearly interest which has an Irish source is subject to withholding tax at a rate of 20%. There are, however, a number of exemptions under Irish law with respect to withholding tax, which would need to be assessed on a case-by-case basis.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Documentary Taxes

Stamp duty for mortgage deeds executed on or after 7 December 2006 is now abolished.

Registration Fees

When a charge is created over most types of assets in Ireland, details of the charge must be filed with the CRO within 21 days of the creation of the security (the main exceptions to this are shares and cash). While the introduction of the Companies Act 2014 saw the introduction of mandatory e-filing for certain forms such as Form C1 (Registration of a Mortgage or charge created by Irish company), many forms could not be filed online. The CRO online portal received an overhaul in December 2020 and, as a result, most forms can now be filed online, including the following.

- A Form C1 (Registration of a Mortgage or charge created by an Irish company) must be completed online. The registration cost (this

includes the registration of Forms C1A and C1B) is EUR40.
- In the case of registered external companies, the cost of registering Form e-F8 and Form e-F8A (Registration of particulars of a charge on property in the State created by a company incorporated outside the State – there is no cost to register Form e-F8B) is EUR40.
- Registering a Form C6 (Declaration of satisfaction of a charge) or Form C7 (Declaration of partial satisfaction of a charge) costs EUR15. These forms must be filled out online.

There is no fee payable in relation to a Section 1001 notice to the Irish Revenue Commissioners.

In relation to intellectual property, as trade mark attorneys are used to make the registrations, their costs differ quite substantially depending on whether local as well as international filings are to be made.

The cost of registering the security in the Registry of Deeds is EUR50 for each deed registered. The cost of registering security in the Land Registry is EUR175.

Notaries' Fees

There is no set fee for the services of a notary in Ireland. A proper professional fee is usually paid dependent on the time spent, the skill of the notary in question and the level of responsibility.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Generally, withholding tax is the material consideration for non-Irish lenders and, as mentioned at **4.1 Withholding Tax**, there are a number of exemptions available under Irish law. In addition, loans that are secured directly or indirectly on Irish real estate may fall within the scope of Irish capital gains tax and an Irish tax clearance certificate called a Form CG50A may be required from Irish Revenue in advance of any transfer of such loans. In the absence of such a certificate, a purchaser may be required to deduct 15% withholding tax from the purchase price payable for such loans. This follows published practice of Irish Revenue to treat such loans in this way.

5. Guarantees and Security

5.1 Assets and Forms of Security

Real Estate

Real estate includes real "immovable" property, as opposed to personal property. It includes:

- any piece of land and the buildings on it;
- the airspace above the land, the ground below it and any natural resources on it;
- anything fixed, immovable or permanently attached to land; and
- title to land can be freehold or leasehold in nature and can be registered or unregistered.

Common forms of security

The following forms of security can be taken over real estate.

- Legal mortgage: before the implementation of the Land and Conveyancing Law Reform Act 2009 (the "2009 Act"), the mechanism for creating a legal mortgage over land varied between registered and unregistered land. However, legal mortgages post 1 December 2009 are now covered by the same rules, irrespective of whether the land is registered or unregistered in nature.
- Equitable mortgage: the 2009 Act has not had any effect on the creation of equitable mortgages. It is generally agreed that an equita-

ble mortgage may be created in Ireland in a number of ways:

(a) where money is advanced on the assumption that a mortgage has been created;
(b) where there is an agreement for a legal mortgage;
(c) by deposit of title deed; and
(d) where the mortgagor holds an equitable interest only in the land at the time of creating the mortgage.

- Fixed charge: a fixed charge is, for example, a specific charge on the specific property of a company – eg, on the land and buildings of the company, as security for a loan. A fixed charge invariably involves the vesting of a legal interest in the chargee at the time of the transaction. A fixed charge over land effectively places an embargo on the borrower, precluding them from disposing of the land without the lender's consent or the discharge of liabilities owed to the lender.
- Floating charge: a floating charge over land is quite unusual, and is more appropriate or usual in respect of other assets such as stock.

Formalities

It is generally agreed that registration is the "operative perfection mechanism in respect of security interests in land". The specific formalities in relation to real estate in Ireland depend on whether the land is registered or unregistered. There are no specific time limits in respect of registration in the Registry of Deeds or Land Registry. The 2009 Act introduced compulsory first registration in respect of sales of interests in unregistered land, applicable to all counties as of 1 June 2011.

As mentioned in **4.2 Other Taxes Duties, Charges or Tax Considerations**, registration requirements with the CRO also exist in respect of Irish corporate bodies. If a company has created a mortgage or charge over real estate, a relevant filing must be lodged with the CRO within 21 days of the creation of the security. Section 412 (3) of the Companies Act 2014 provides that the priority of a charge will be determined by the date and time of receipt by the registrar of a fully filed charge submission, not the date of the creation of the charge, therefore timely filings are of significant importance. Failure to register the charge, by delivering details to the CRO within 21 days of the creation of the charge or notice to create the charge, will result in making the charge void against a liquidator of the company and any creditors.

If a company has failed to comply with Section 409 of the Companies Act 2014, an application can be made under Section 417 of the Companies Act 2014 to the High Court for an order requesting an extension of the time afforded to effect registration of the charge. If the registration requires amending, based on an omission or misstatement, an order of rectification can also be applied for under these provisions.

When the CRO is satisfied that the statutory requirements have been met, a certificate of charge is issued. The certificate is conclusive evidence that the requirements of the Companies Act 2014 have been complied with.

Tangible Movable Property

Tangible movable property in Ireland could include trading stock (inventory), agricultural stock, goods, plant, machinery and vessels such as aircraft or ships.

Common forms of security

The following forms of security can be taken over tangible movable property: a fixed charge and a floating charge.

A fixed charge attaches to a specific asset or class of assets on creation. With a floating charge, the security "floats" over the asset and remains dormant until some further step is taken by or on behalf of the chargee. This enables the borrower to deal with the asset over which the charge is created in the ordinary course of business, until the floating charge crystallises into a fixed charge.

Crystallisation of a floating charge into a fixed charge may occur on the happening of a specified event or on insolvency of the borrower. These could be such as when a receiver is appointed, or a winding-up commences, or if the chargee intervenes when entitled to do so. An automatic crystallisation clause is one stipulating that a floating charge will crystallise on some specific event occurring. The introduction of the Companies (Accounting) Act 2017 clarifies that crystallised floating chargeholders will not take priority over certain preferential creditors, such as claims of employees and certain taxes on a winding-up.

It should be noted that floating charges have certain weaknesses, including:

- they have weak priority against purchasers (who are not on notice of any negative pledge contained in the floating charge) and chargees of the assets concerned and against lien holders, execution creditors and creditors with rights of set-off;
- they rank after certain preferential creditors, such as claims of employees and certain taxes on a winding-up;
- they rank after certain insolvency remuneration expenses and liabilities;
- the examiner of a company has certain rights to deal with the property covered by the floating charge;
- they are affected by Section 597 of the Companies Act 2014 (Circumstances in which a floating charge is invalid); and
- they rank after fixed charges.

Formalities

For general registration requirements, please see above. Specific formalities apply in relation to different categories of assets.

Agricultural stock

A fixed and/or floating mortgage can be created over agricultural stock provided the chattels in question comply with the terms of the Agricultural Credit Act 1978 (as amended) and are the absolute property of the mortgagor. Specific rules apply in relation to registration. If capable of being registered, and in order to be effective, the security interest must be registered in accordance with the terms of the Agricultural Credit Act 1978. Essentially, the security must be registered within one month of creation with each Circuit Court in each district where the mortgagor's land on which the chattels are situated is located.

Aircraft

A mortgage or fixed charge can be created over aircraft. The registration requirements in respect of aircraft are twofold:

- first, where certain conditions are met, registration of the interests of relevant parties may be required under the terms of the Convention on International Interests in Mobile Equipment (Cape Town Convention);

- second, the regular CRO filings are required – registrations are made on a priority basis and notice of the security interest should also be affixed to the aircraft.

Movable plant and machinery

Security over a movable plant and machinery would typically be done by way of a fixed or floating charge. Registration should be made at the CRO and notification by affixing the security interest to plant or machinery.

Ships

Security over a ship must be done by way of statutory ship mortgage. Any security created over a vessel must be registered with the appropriate Registrar for Shipping. The Registrar for Shipping registers statutory ship mortgages on a priority basis. Notice of the security interest should also be affixed to the vessel.

Financial Instruments

Financial instruments are defined in Directive 2002/47/EC on financial collateral arrangements, as amended by Directive 2009/44/EC and Directive 2014/59/EU, which has now been transposed into Irish law as including:

- shares in companies and other securities equivalent to shares in companies;
- bonds and other forms of instruments giving rise to or acknowledging indebtedness if these are tradable on the capital market; and
- any other securities that are normally dealt in and which give the right to acquire any such shares, bonds, instruments or other securities by subscription, purchase or exchange or which give rise to a cash settlement (excluding instruments of payment).

Common forms of security

Common forms of security are:

- legal mortgage;
- equitable mortgage;
- fixed charge; and
- floating charge.

Note that there are certain advantages (and disadvantages) of creating a legal mortgage as opposed to an equitable mortgage in the creation of security under Irish law.

Formalities

In general, any ancillary documentation should be sought in connection with any security over shares. This may include stock transfer forms and the original share certificates. An affidavit and stop notice can also be served on the company whose shares are being charged to put them on notice that the shares have been charged.

Claims and Receivables

The most common types of claims and receivables under Irish law over which security is granted include bank accounts and rent.

Common forms of security

It is generally not common to take security over receivables in Ireland except by way of floating charge. However, security can also be created by way of:

- a mortgage in the form of a security assignment; and
- a fixed charge.

Formalities

The parties must ensure that the contract creating the trade receivable does not contain a prohibition on assignment. A security assignment over receivables is registrable as a fixed charge over book debts and must be registered with the CRO within 21 days. Note that a Section

1001 filing should be made with the Irish Revenue Commissioners within this 21-day period, in accordance with the terms of Section 1001(3) of the Taxes Consolidation Act 1997.

Cash Deposits

Common forms of security

The most common forms of security over cash deposits are:

- security assignment;
- fixed charge; and
- floating charge.

Formalities

Where a fixed charge or assignment has been created by a company, a Section 1001 notice in relation to book debts must also be filed with the Irish Revenue Commissioners, under Section 1001(3) of the Taxes Consolidation Act 1997. The Irish Revenue Commissioners must be notified of the creation of the charge over book debts within the same 21-day period, and acknowledgement received from the Irish Revenue Commissioners that they have received the notification and updated their records accordingly.

For a security assignment, to create a legal as opposed to an equitable security interest, a notice of the assignment of the bank account must be served on the account-holding bank informing it that the account has been assigned. There is no timeframe within which this notice must be served and the bank need not acknowledge the notice for it to be valid.

Fixed charges on bank accounts can be re-characterised as floating charges if the requisite prohibition on dealing with the account and the monies in the account is not adequately provided for in the security document notice to the account bank.

Under the Companies Act 2014, a charge created over an interest in cash or money credited to an account of a financial institution or any other deposits does not require registration with the CRO.

Intellectual Property

The most common types of intellectual property over which security is granted in Ireland include:

- patents;
- trade marks; and
- copyright.

Common forms of security

The most common forms of security granted over intellectual property are:

- legal mortgage;
- equitable mortgage; and
- fixed or floating charge (depending on the notion of intellectual property).

For example, in relation to patents, a mortgage and/or charge may be taken.

Formalities

Registration is required at the CRO within 21 days of creation. Registration can also be required with the following entities, where relevant:

- Irish Patent or Trade Marks Office;
- European Patent Organisation;
- the Patents Office; and
- regional intellectual property offices such as the EPO or EUIPO, as appropriate.

Certain local laws may take precedence over Irish law when it comes to fulfilling registration requirements. In addition, both patents and

trade marks can be registered, however copyright arises automatically and is not registerable.

5.2 Floating Charges and/or Similar Security Interests

A floating charge over all present and future assets is commonly accepted by lenders as a form of security in Ireland.

5.3 Downstream, Upstream and Cross-Stream Guarantees

It is possible for an Irish incorporated entity to provide downstream, upstream and cross-stream guarantees, so long as the provision of such a guarantee does not breach any terms or limitations contained in the company's constitution or in the Companies Act 2014. Among the statutory restrictions in place under the Companies Act 2014 are:

- Section 239, prohibiting a company from entering into credit transactions for the benefit of a director and/or connected persons; and
- Section 82, prohibiting the provision of financial assistance by a company for the purchase of its own shares.

Where a guarantee cannot be provided due to the terms or limitations of a company's constitution, a shareholder's special resolution must be executed amending the constitutional prohibition/limit. This resolution must then be filed in the CRO with a Form G1 (Amending the Constitution). Where a guarantee is prohibited under Sections 239 and 82 of the Companies Act 2014, the relevant obligor will need to consider whether an applicable exemption applies and failing this they must conduct a "Summary Approval Procedure" (SAP). SAPs are discussed in **5.4 Restrictions on the Target**.

5.4 Restrictions on the Target

Under Section 82 of the Companies Act 2014, it is unlawful for a company to give any financial assistance for the purpose of an acquisition made or to be made by any person of any shares in that company, or, where the company is a subsidiary, in its holding company. The statutory prohibition is broadly drafted, with the main rationale being the preservation of a company's capital and shareholder/creditor protection.

Financial assistance may only be given in limited circumstances, such as where it falls within one of the legislative exceptions or where a SAP has been followed under Section 202 of the Companies Act 2014.

A SAP is a means by which companies can engage in certain restricted activities by ensuring that the persons those restrictions are designed to protect, consent to the restricted activity being carried out. There are seven "restricted activities" for which the SAP can be used to validate otherwise prohibited transactions, including the provision of financial assistance. The directors are required to set out the circumstances in which the transaction or arrangement is entered into and the benefit that will accrue to the company. The directors are required to swear a declaration of solvency setting out their reasonable belief that the company will remain solvent for the next 12 months. Failure to deliver the directors' declaration to the CRO within 21 days invalidates the activity in question.

The Companies Act 2014 amended the previous regime in relation to financial assistance in that the prohibition against it has been narrowed, such that the giving of financial assistance may not be prohibited if the acquisition of shares is not the principal purpose of the financial assistance. The Companies Act 2014 also provides

for the giving of assistance for the purpose of acquiring the shares where it is only an incidental part of some larger purpose of the company, and the assistance is given in good faith and in the interests of the company.

5.5 Other Restrictions

The various restrictions (and related costs, if any) in relation to the granting of security or guarantees has been set out in **5.4 Restrictions on the Target**.

5.6 Release of Typical Forms of Security

In the case of fixed security, the chargee executes a deed of release. In the case of floating security, the security giver can deal with the secured assets in the ordinary course of business until such time as the floating security crystallises into a fixed charge.

A Form C6 (full release) or Form C7 (partial release) needs to be registered with the CRO. This can be completed by the chargor and, on receipt, the CRO practice is to notify the person(s) entitled to the charge that a memorandum of satisfaction has been received for registration. The person(s) entitled to the charge then has 21 days to lodge an objection to the registration of the memorandum of satisfaction. If no objection is received, the satisfaction is registered and the security released. Alternatively, Form C6 or Form C7 can be completed by the chargee and no notification is necessary, and the satisfaction is simply registered.

If security was granted over real estate located in Ireland, it will also be necessary for the chargor to execute a Land Registry discharge document, in addition to the deed of release, by way of a Form 57A. This discharge document is then registered with the Property Registration Authority to release the security over underlying real estate.

5.7 Rules Governing the Priority of Competing Security Interests

Contractual Subordination

Contractual subordination is possible and common in Ireland. It occurs where the senior lender and the subordinated lender enter into an agreement as a result of which the subordinated lender agrees that the senior debt will be paid out in full before the subordinated lender receives the payment of the subordinated debt, creating a contractual subordination.

Structural Subordination

Structural subordination is also possible depending on the particular terms of a transaction. Structural subordination arises where one lender (the senior lender) lends to a company in a group of companies which is lower in the group structure than another lender (the subordinated lender).

Intercreditor Arrangements

Intercreditor arrangements are common in Ireland. Typical parties include a senior lender, a junior lender, inter-group lender and a borrower. Typical terms in an intercreditor agreement include provisions as to priorities, standstill, representations and warranties, covenants and other standard clauses.

5.8 Priming Liens

Liens allow a lienholder/lender to retain possession of property (usually goods or documents) until debts in respect of goods or services have been discharged. There are various types of liens under Irish law which include liens arising by operation of law. Typically, lenders risk accept such liens and permit them provided that they

are in the ordinary course of trading and not as a result of some default.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

The circumstances in which a lender can enforce its loan, guarantee or security interest under Irish law are largely dependent on the terms of the underlying loan and as set out in the security documentation. Typical events of default that are often contained in loan agreements in Ireland might include:

- non-payment by the borrower of the principal amount or interest when due;
- insolvency, such as the appointment of an examiner, receiver or liquidator, or the occurrence of some other specified insolvency event that may be affecting the borrower;
- non-compliance, such as a failure to observe the covenants or comply with the representations and warranties as set out in the loan agreement;
- material adverse change, such as a change in the financial condition of the borrower; or
- cross-default.

The normal methods of enforcement are for the security holder to appoint a receiver, pursuant to the terms of the charge deed, or for the chargeholder to become a mortgagee in possession of the charged asset. Generally speaking, a court order is not necessary to appoint a receiver, although in the case of real property, it may be necessary to obtain a court order for possession if the security holder intends to go into direct possession. Once possession is obtained it is not usually necessary to get a court order for sale.

Appointing an Examiner

Enforcement may be prevented by the appointment of an examiner to the company (that has created the security). The examiner is appointed by the court where a creditor, shareholder or the company petitions the court and the court is satisfied that there is a reasonable prospect of the company's survival as a result of this appointment.

The examiner is typically appointed for 70 days (this could be extended to 100 days in exceptional cases) during which time the examiner will endeavour to put a scheme of arrangement, subject to approval by the interested parties and the court, in place where the company's creditors write off part of the amounts owing to them and the company continues to trade.

6.2 Foreign Law and Jurisdiction

Choice of Foreign Law

The Rome I Regulation and Rome II Regulation have force of law in Ireland and the purpose of both regulations is not to harmonise the actual law of EU states that applies to contractual and non-contractual obligations respectively, but to harmonise the rules that determine what law applies to contractual and non-contractual disputes, with the aim of ensuring that the courts in the EU are uniform in their application of laws in international disputes, thereby reducing the risk of forum shopping. The choice of foreign law as the governing law of the contract, will therefore be upheld by the courts of Ireland, provided that the relevant contractual or non-contractual obligation is within the scope of the relevant regulation.

Submission to a Foreign Jurisdiction

Pursuant to the provisions of the Brussels Regulation Recast (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 submission by an Irish natural person, or a company incorporated in Ireland to the jurisdiction of the courts of another EU member state, will be upheld in the Irish courts.

Immunity

Waivers of immunity are effective under Irish law.

6.3 Foreign Court Judgments

Provided that neither Article 45 (Refusal of recognition) nor Article 46 (Refusal of enforcement) of the Brussels Regulation Recast is applicable, and subject to general compliance with the Regulation, any judgment given by a foreign court or an arbitral award against a company would be recognised and enforced in Ireland, without a retrial of the merits of the case.

6.4 A Foreign Lender's Ability to Enforce Its Rights

There are no other matters under Irish law which might impact a foreign lender's ability to enforce its rights under a loan or security agreement.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

Security may be set aside in certain circumstances at the beginning of insolvency procedures. There will also be a stay of execution concerning the appointment of an examiner.

7.2 Waterfall of Payments

The priority in which claims are paid is generally as follows:

- Section 554 of the Companies Act 2014 – remuneration, costs and expenses of an examiner sanctioned by the court are paid in full before any other claim, secured or unsecured, in any receivership or winding-up of the company;
- fixed chargeholders (assets that are subject to a fixed charge belong to the security holder and not to the company and, accordingly, whether or not the liquidator deals with them is at the behest of the secured creditor);
- expenses certified by an examiner under Section 529 of the Companies Act 2014 rank after claims of fixed chargeholders (Section 554(3), Companies Act 2014);
- costs and expenses of the winding-up (priorities in relation to costs in a liquidation are set out in the Rules of the Supreme Court, Order 74, Rule 128);
- fees due to the liquidator;
- any claim under Section 16(2) of the Social Welfare (Consolidation) Act 1993;
- preferential debts, for example, rates and taxes, wages and salaries (Section 621, Companies Act 2014);
- floating charges, ranking in the order of their creation;
- unsecured debts, ranking pari passu (equally) with each other; and
- deferred debts, ranking pari passu with each other.

Regarding Section 16(2) of the Social Welfare (Consolidation) Act 1993 mentioned above, any sum deducted by an employer from the remuneration of an employee in respect of an employment contribution due by the employer and unpaid by it does not form part of the assets of a limited company in a winding-up. Further, a sum equal to that deducted is paid into the Social Insurance Fund ahead of all preferential debts (super preferential claim).

Within each ranking, all claims in one category receive full payment before any remaining proceeds are distributed to creditors in the following category. When proceeds are insufficient to meet claims of one category in full, payments thereon are paid pro rata.

It is possible for the secured creditors to agree among themselves, where desired, the order of application of the proceeds of the enforcement of their security so far as their secured claims are concerned.

7.3 Length of Insolvency Process and Recoveries

Other than the rescue/reorganisation procedures and the timelines outlined in **7.4 Rescue or Reorganisation Procedures Other Than Insolvency**, in broad terms, receivership and liquidation are considered. It is difficult to provide a timeline as it is dependent on how long it takes for a receiver/liquidator to assess the company, consolidate the assets and complete a sales process. There is an obligation on a receiver to "obtain the best price reasonably obtainable".

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

There are two main company rescue procedures available in Ireland: (i) examinership; and (ii) company voluntary arrangements (CVAs).

Examinership is the main rescue procedure for companies nearing insolvency. The emphasis is on introducing a scheme of arrangement that assists the survival of the company as a going concern. To aid this process, the company is granted court protection so that, in effect, the rights of the creditors and other third parties against the company are frozen for a period of time (which is currently a maximum of 150 days, plus the time required by the court to make the decision). It is commenced by a petition to the court by any of the directors, creditors or shareholders.

A CVA is a court-sanctioned procedure to enable a company in financial difficulty to reach a compromise or arrangement with its creditors and avoid liquidation. It is rarely used in practice, as a secured creditor is free to enforce its security while the CVA is pending.

Making Examinership Accessible

Section 509(7)(b) of the Companies Act 2014 provides for what is colloquially referred to as "examinership-lite". Small private companies that meet certain criteria can apply directly to the Circuit Court to have an examiner appointed, rather than applying to the High Court. While the measure was intended to make examinership more accessible for small private companies, there has not been much uptake. As a result, the Companies (Rescue Process for Small and Micro Companies) Act 2021 was signed into law on 22 July 2021. This provides for a new rescue process to be made available to small and micro companies. While it adopts some of the key examinership principles, the process is more administrative, rather than court-led, in order to make it more cost-effective. Applications can still be made for court protection orders.

7.5 Risk Areas for Lenders

The following are some potential risk areas from the lender's perspective, should a borrower, security provider or guarantor become insolvent.

Financial Assistance

See **5.4 Restrictions on Target**.

Corporate Benefit

As part of their fiduciary duties, the directors of an Irish company have an obligation to act in

what they consider to be the best interests of the company they direct. The transaction must be for the company's commercial benefit and these requirements should be recorded in the board minutes of the company.

Directors must ask whether they can justify their company providing security for another company's obligations and whether a corporate benefit will accrue. The risk of giving third-party security must be balanced against the actual or potential rewards. A parent company might justify giving security for a subsidiary's borrowings (downstream security) because it will, directly or indirectly, hope to receive dividends from the subsidiary, or will benefit from any enhanced commercial value in their role as shareholder.

Alternatively, a subsidiary might justify supporting its parent (upstream security) because of the support it receives from its parent in, for example, its marketing terms.

However, there are authorities to suggest that security can still be given, even where there is insufficient corporate benefit (Rolled Steel Products Limited v BSC [1985] All ER 52; West Mercia Safetywear Ltd v Dodd [1988] BCLC 250) if:

- the company's shareholders unanimously agree;
- the company is not insolvent at the time and does not become insolvent as a result of the transaction; and
- a company can sacrifice its short-term interests for the good of the group (Re PMPA Garage (Longmile) Limited [1992] ILRM 337).

Additionally, the granting of security and the liability incurred in respect of which the security was given must be within the objective of the company as set out in its memorandum of association, otherwise it will be ultra vires and therefore void. However, this is no longer a requirement for limited companies under the Companies Act 2014, which has abolished the ultra vires doctrine in respect of such companies.

Interests of employees and directors' duties

It is now also a requirement for the directors of an Irish company to consider the interests of its employees (Section 224, Companies Act 2014). Under Section 1112 of the Companies Act 2014, there is an obligation on the directors of private limited companies to ensure that the person acting as company secretary has the necessary skills and resources to discharge their statutory duties.

Under the Companies Act 2014, the duties of a director have been codified to reflect common law principles. The principal fiduciary duties have been listed in Section 228 of the Companies Act 2014. Under Section 233, a director is now required to make a statement acknowledging their duties under the law, and Section 225 requires a director to make a compliance statement when the company's balance sheet total for the year exceeds EUR12.5 million and the amount of its turnover for the year exceeds EUR25 million.

Loans to Directors

Under Section 239, a company is prohibited from providing security in favour of a person who makes a loan (or a quasi-loan) to, or enters into a credit transaction with, a director of that company or its holding company, or a person connected to that director (as defined in Section 220). There are a number of exceptions, including where the transaction occurs with a member of the same group. These transactions can sometimes be summarily approved, but caution

must be exercised as the Summary Approval Procedure is limited and is not intended to be deployed as a "catch-all" mechanism.

Usury

The outcome of the Breccia case was discussed in **3.10 Usury Laws**.

Others

Other laws to consider include the following.

Section 610 of the Companies Act 2014

Section 610 of the Companies Act 2014 relates to fraudulent or reckless trading. Fraudulent trading essentially means the carrying on of the business of a company with intent to defraud creditors or for any fraudulent purpose.

If, in the course of a winding-up, it appears that any person was knowingly a party to the carrying on of any business of the company with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose (fraudulent trading), that person may be exposed to personal liability for all or any part of the debts or other liabilities of the company. Fraudulent trading can attract both civil and criminal liability.

Civil liability can be imposed on any person for "reckless trading" where it appears, in the course of winding-up or examinership proceedings, that while an officer of a company, they were knowingly a party to the carrying on of any business of the company in a reckless manner or were engaged in fraudulent trading. Such a person may also be held personally responsible for all or part of the debts and liabilities of the company.

Section 238 of the Companies Act 2014

Subject to certain exceptions, Section 238 of the Companies Act 2014 prohibits a company from acquiring assets from, or disposing of assets to, a director of the company, or of its holding company, or to a person connected with such a director, unless the company's shareholders and, in some cases, the shareholders of its holding company approve the acquisition or disposal. The consequences of a breach of Section 238 are that:

- the transaction is voidable at the instance of the company; and
- any director and, if applicable, person connected with them, who has entered into the transaction must account for any gain made by them and reimburse the company for any loss made by it.

8. Project Finance

8.1 Recent Project Finance Activity

The more recent project finance activity has been focused around environmental and social purposes. There has been activity in relation to the construction of wind and solar farms, as well as activity in relation to the construction of battery storage facilities. Project financing has also been used in relation to the construction of schools, universities and social housing.

8.2 Public-Private Partnership Transactions

Public-private partnership (PPP) is the most widely used project finance infrastructure model in Ireland. Essentially, this involves a public service or asset being funded and operated by the private sector under a long-term concession granted by the relevant public authority.

The government or public authority may provide certain advantages to the project company by way of a guarantee, a grant or use of a state

asset for free or below market value. It should be noted that, in certain circumstances, such arrangement may be prohibited by the State Aid Rules.

8.3 Governing Law

Typically, project documents are governed by local law which would have the benefit of being prepared by local lawyers who understand the local market, particular risk items and have knowledge of the contract counterparties. However, it is not strictly required, and English or New York law could apply with international arbitration used to settle disputes.

8.4 Foreign Ownership

There are no restrictions other than in respect of various lands that are the property of the state – eg, the foreshore.

8.5 Structuring Deals

A project finance deal will normally involve a number of lenders that provide funds to the project. Any potential issues which may arise will be dependent on the type of project that is being financed, so any risk should be assessed and allocated between the parties involved.

The project company will be required to adhere to both Irish and EU laws and regulations (including, but not limited to, competition law) which are specific to the sector in which the project is centred. There are no particular restrictions on foreign investment in Ireland, however, restrictions may apply to foreign investors in relation to certain regulated sectors, but this would need to be assessed on a case-by-case basis.

8.6 Common Financing Sources and Typical Structures

The typical source of financing for PPPs in Ireland would be bank financing and bond issuances.

8.7 Natural Resources

The NRS is the relevant authority in Ireland which deals with natural resources and any policies relating to the acquisition and export of natural resources. The objective of the NRS is to sustainably exploit and manage Ireland inland fisheries, geological resources and oil and gas reserves. Any potential issues or considerations would need to be assessed on the basis of which natural resource is being extracted and comply with the primary legislation outlined in **8.8 Environmental, Health and Safety Laws**.

8.8 Environmental, Health and Safety Laws

The Health and Safety Authority is the main body in Ireland responsible for health and safety laws. The primary legislation includes the Safety, Health and Welfare Act 2005 (as amended from time to time), Chemicals Acts 2008 and 2010, Safety Health and Welfare (Offshore Installations) Act 1987, Safety in Industry Act 1980, Factories Act 1955, and the Dangerous Substances Act 1979 and 1972. The Health and Safety Authority also ensures that various regulations and orders are adhered to and has issued various codes of practice (for example, in relation to chemical agents, working on roads, safety in roof work).

As regards the environment, the national statutory body in Ireland is the Environmental Protection Agency (EPA). The EPA is an independent public body established under the Environmental Protection Agency Act 1992.

Trends and Developments

Contributed by:
Elizabeth Bradley and Ciarán Gallagher
Maples Group

Maples Group advises global financial, institutional, business and private clients on the laws of the British Virgin Islands, the Cayman Islands, Ireland, Jersey and Luxembourg through its leading international law firm, Maples and Calder. With offices in key jurisdictions around the world, the Maples Group has specific strengths in the areas of finance and banking, corporate commercial, investment funds, litigation and trusts. The banking and finance team in the Maples Group's Dublin office has a diverse practice and comprises four partners and five associates. The team acts as lead counsel, as well as local counsel, for lenders and borrowers on a wide range of domestic and cross-border debt financings, including corporate and leveraged finance, real estate finance and funds finance, and provides commercially focused and solutions-oriented advice to clients. The firm's international perspective, working with both Irish and international financial and institutional clients, ensures best-in-class advice.

Authors

Elizabeth Bradley is a partner of Maples and Calder's Banking and Finance team in the Maples Group's Dublin office. Elizabeth specialises in banking and finance law, advising clients in structuring, negotiating, implementing and restructuring a range of financing transactions. She acts for leading domestic and global financial institutions, alternative lenders, major corporates, private equity funds and limited partnerships across a wide range of domestic and cross-border finance transactions. These include real estate financing (investment and development), acquisition and leveraged finance, project finance and fund financing, through bilateral and syndicated deals. Elizabeth also advises on loan portfolio sales, acting for purchasers, vendors and servicers.

Ciarán Gallagher is an associate of Maples and Calder's Banking and Finance Team in the Maples Group's Dublin Office. He works across a wide variety of clients which include lenders and borrowers both domestically and internationally. Ciarán advises on matters such as real estate finance, acquisition and leveraged finance, development finance and fund finance.

Contributed by: Elizabeth Bradley and Ciarán Gallagher, **Maples Group**

Maples Group

75 St. Stephen's Green
Dublin 2
D02 PR50
Ireland

Tel: +353 1 619 2000
Fax: +353 1 619 2001
Email: dublininfo@maplesandcalder.com
Web: www.maples.com

Overview

To date, 2023 has been a year that has brought about significant challenges as well as substantial changes to the Irish banking market – challenges and changes that will shape the market's path going forward.

In 2022, we saw Ulster Bank Ireland DAC ("Ulster") and KBC Bank Ireland (KBC) continue to sell off their loan book and wind down operations in Ireland with its final conclusion of operations this year. We also saw the impact of war on the global economy by the Russian invasion of Ukraine and this in turn kick-started an unrelenting period of inflation and high interest rates which has continued through to this year.

With the shadow of the macroeconomic factors being cast over much of this year, it has prompted a moment of reflection by borrowers and lenders alike.

Given this current backdrop, what follows is an overview of the trends and developments in the banking and finance market in Ireland for 2023.

Irish Economic Trends and Developments

Following the announcement in 2021 of the exit of Ulster and KBC from the Irish market, on 3 February 2023, the legal ownership of KBC mortgages, deposits, credit card and business and personal loan accounts transferred to Bank of Ireland. Ulster officially closed for business on 21 April 2023, with Permanent TSB and AIB acquiring the majority of its loans and assets. This has significantly altered the Irish banking landscape, with the market now reduced to three domestic Irish banks.

These departures from the Irish market have nevertheless not deterred the remaining pillar banks of AIB, Bank of Ireland and Permanent TSB from investing back into the market by coming together for a joint venture in developing "Synch", an instant payment platform for Irish consumers and businesses to rival and compete with the existing neo-banks such as Revolut. This will be achieved through the development of a mobile application known as "Yippay" to facilitate instant payments between customers through the use of a phone number alone. Initially, it will provide a peer-to-peer service for retail and business customers, and eventually broaden to person-to-merchant payments. Once established, it is intended that Synch's services will expand to the merchant acquirer sector to provide an alternative to in-store and online merchant card acceptance. Synch received

clearance from the Irish Competition and Consumer Protection Commission in June 2022 and intends to launch in 2024 pending authorisation from the Central Bank of Ireland (CBI).

Non-Bank Lenders

The withdrawal of Ulster and KBC from the Irish market could have the potential to reduce competition but has in fact created more opportunities for non-bank lenders (NBLs). NBLs have featured in the Irish market for over a decade and are a key source of funding for Irish property and small and medium-sized enterprises (SMEs) while also being a catalyst for competition. The emergence of more alternative lenders, which includes the likes of Wayflyer, BlueBay Asset Management and Novellus, and their significant growth over the recent years is evidence of an exciting diversification in the Irish market.

While NBLs may be more exposed to the unstable global financial conditions in the market, the Central Bank's Financial Stability Review 2023 reports that NBLs have proven resilient to the rising interest rates showing a greater risk appetite and flexibility by offering multi-currency revolving facilities as well as term loan single currency facilities.

It is clear that the dynamic of the Irish banking sector is changing with NBLs expected to continue the evolution in the lending landscape in Ireland and indeed carve out their own lending ecosystem.

Interest Rates

Over the last year, we have seen the Irish market follow the global trends of high inflation rates alongside increasing interest rates. At the time of writing, interest rates have surpassed 4% and are at their highest rate in over 20 years, with nine consecutive increases in a twelve month period by the ECB. In turn, the Irish pillar banks have increased their interest rates on variable and fixed-mortgages. The immediate effect of this is the increased cost of funds for borrowers resulting in a significant reduction in lending activity in Ireland this year, particularly in the real estate sector. However, the banks have yet to pass on these interest rate increases to their savings customers and deposit holders, and have recently been criticised by government for failing to do so, with the Minister for Public Expenditure advising Irish savings account holders to deposit their savings with other European banks in order to benefit from much higher interest rates than those available in Ireland. This provides another opportunity for non-Irish banks in the Irish banking market.

At the time of writing, the rate of inflation in Ireland is 4.8% compared to an average 5.5% inflation rate across the Euro area. As we look to the remainder of 2023, the outlook for the Irish banking market will depend on the ECB's decision making – whether it will continue to pursue the aggressive target of a 2% inflation rate over the medium term, or whether there will be an acceptance that inflation and interest rates have reached a standing position whereby the market will find a new level in order to encourage lending activity again.

Sustainable Finance

Notwithstanding the challenges that increased inflation and interest rates bring to bear, Ireland has continued its progress towards establishing itself as a sustainable finance centre in line with the Sustainable Finance Roadmap (the "Roadmap") published by Sustainable Finance Ireland in 2021. In February 2023, the International Sustainable Finance Centre of Excellence (ISFCOE) hosted its first Communities of Practice meetings which brought together ISFCOE members

and sustainable finance professionals to collaborate as a community. Members of the ISFCOE, which comprises of a mix of public/private participants including IDA Ireland, AIB, Bank of Ireland, other financial institutions and professional services including the Maples Group, are working together to drive Ireland forward in becoming a leading sustainable finance centre.

The Department of Finance in the meantime launched its 2023 Action Plan to reflect its update to the Ireland for Finance Strategy, which was originally published in 2019 (the "Action Plan"). The Action Plan sets out key measures to be taken to support the further development of the international financial services sector in Ireland. The sustainable finance theme of the Action Plan sets out two key deliverables. Firstly, the Roadmap will be updated to reflect developments in sustainable finance with particular focus on the net-zero transition, biodiversity finance and the implementation of the sustainable finance fintech strategy. The second deliverable will see IDA Ireland, in collaboration with stakeholders Financial Services Ireland, ISFCOE and the Department of Finance, develop an updated Sustainable Finance Proposition to promote the potential for further investment in sustainable finance and develop the value proposition for foreign direct investment into Irish sustainable finance activities by targeting investors.

EU Framework

The 2023 Action Plan and the Roadmap are bolstered by the EU Regulation on the Establishment of a Framework to Facilitate Sustainable Investment (more commonly known as the Taxonomy Regulation (TR)) and the Sustainable Finance Disclosure Regulation (SFDR), both adopted in June 2020. The TR and SFDR have been subject to important developments in recent months.

In June 2023, the European Commission adopted the Environmental Delegated Act to the TR setting out the screening criteria for its remaining environmental objectives taking effect on 1 January 2024. This offers clarity to the entities subject to the TR by setting out the non-climate environmental objectives under the TR such as pollution prevention, biodiversity protection and specifying criteria to determine whether economic activities, including finance related activities, cause significant harm to any of these objectives.

The major development in the SFDR, which requires financial service providers to disclose environmental, social, and governance (ESG) considerations publicly, is that it has now entered its phase 2. This will mean that the reporting obligations will now be fully applicable to financial market participants with over 500 employees and will certainly require companies fitting the criteria to review their ESG policy and their broader responsibilities with regard to ESG in conducting their business.

In addition to these EU regulations, the Corporate Sustainability Reporting Directive ("CSRD") entered into force in January 2023 in Ireland replacing the Non-Financial Regulation Directive which applied only to large public interest entities. The CSRD requires entities to report on a double materiality basis meaning that companies will have to disclose the risks they face from climate change and other ESG matters (financial materiality) as well as the impact they themselves will have on the climate and society (impact materiality). The reporting obligations under the regulations will begin to apply from January 2024 to public interest entities with over 500 employees. Public interest companies include those that are:

- listed on a regulated EU stock market;
- financial services companies; or
- companies specifically designated a public interest entity by their country of incorporation.

The reporting obligations for large entities with over 250 employees apply from 1 January 2025 with listed SMEs from January 2026. This does however include an "opt-out" possible until 2028. While non-listed Irish SMEs are not in scope of CSRD, these entities may need to provide information to larger companies if they form part of the value chain. With these additional reporting requirements, we have seen an uplift in Irish companies beginning to inform and equip themselves in anticipation of this potentially challenging change of landscape.

Ireland's Green Financing Trends

In 2023, we have seen green bonds continue to grow in popularity as investment vehicles for sustainability. The AIB and BOI green bond issuances have continued to increase under their green bond frameworks. So far this year, BOI has issued EUR1.5 billion green bonds, bringing its total issuance to date to circa EUR4 billion with AIB's 2023 half-yearly green finance performance showing issuances of EUR1.1 billion and over EUR3 billion green bonds now in issuance.

The National Treasury Management Agency has also raised EUR3.5 billion through the syndicated sale of a 20 year Irish Sovereign Green Bond (ISGB) maturing in 2043, the second ISGB since inaugural issue in 2018. The money raised will be used under the terms of the Irish Sovereign Green Bond framework. This Government-approved framework lists six eligible categories of green projects supporting the pillars and actions set out in the 2023 Action Plan and demonstrates the government-wide support for sustainable finance in Ireland in the long term.

NBLs and other alternate lenders are also driving a shift towards green financing with the Irish-based Capitalflow Group securing EUR10 million from the low-cost Energy Efficiency Loan Scheme (EELS) launched in 2022 by the Strategic Banking Corporation of Ireland. This is a state-owned lending institution aimed at ensuring access to funding for Irish SMEs. Some other on-lenders of the EELS include AIB, BOI, Fexco Assets Finance and Finance Ireland. Loans of up to EUR150,000 can be applied for under the scheme which will see the positive effects of green financing in the form of energy-efficient products financed at a fixed rate.

ESG in Practice

With ESG issues continuing to be a focus for not only Irish financial institutions but their borrowers too, there has been a steady increase in the inclusion of ESG related covenants in Irish law loan agreements in order to qualify them as sustainability-linked loans. Significantly, the Loan Market Association (LMA) published draft provisions for sustainability-linked loans in May 2023, the first form of prescribed drafting since the initial publication of the sustainability-linked loans principles in 2019 and guidance in 2020. Given that such provisions act as a framework only, we are starting to see the likes of the Irish pillar banks and NBLs producing their own working template. The setting out of a clear basic format and terminology represents a positive shift towards standardised drafting in documenting sustainability-linked loans and provides a good starting point for negotiation given the increased investor interest and demand.

Fund Financing

ICAV & ILP update and the use of cascading pledges

Over the last number of years, the Irish Collective Asset-management Vehicle (ICAV) has established itself as the most commonplace structure in the Irish fund financing space. The ICAV is a bespoke corporate structure with its own legislative framework regulated by the CBI with a unique feature of the ICAV being that it cannot provide third-party credit support for any third party by way of guarantee. In practice, this means that where an ICAV forms part of a master-feeder structure in a subscription line financing, the lender cannot take direct security from the ICAV feeder fund over its uncalled capital commitments and capital call rights.

The use of cascading security structures to overcome this restriction is not a new feature of the fund financing market, but it is a recent growing trend when an ICAV forms part of the borrowing structure. In short, the "cascading pledge" means the ICAV creates security over its uncalled capital commitments in favour of its master fund, which then assigns this security interest on to the lender.

Key considerations when implementing the cascading structure include:

- whether the ICAV's offering documents permit the granting of security over its capital call rights and uncalled capital commitments;
- the requirement for side letters with the alternative investment fund manager (AIFM), administrator and investment manager (as applicable) in order to document who has authority to make the capital calls and enforce the capital call rights; and
- the terms of acknowledgement from the ICAV as the feeder fund with regard to the borrower financing and the cascading pledge arrangement bearing in mind the guarantee restriction.

It is also important that the feeder fund ICAV is not party to the subscription line facility agreement lest it trip itself up when it comes to the guarantee restriction but equally it is fundamental that the events of default are drafted to include default on the part of the ICAV feeder fund under the cascading security documentation. This alternative approach to the guarantee is now a widely accepted practice in subscription line financing involving ICAVs.

Though the ICAV has been the Irish fund vehicle of choice in the Irish market when it comes to fund finance, we are starting to see another Irish fund structure in the mix – the Investment Limited Partnership (ILP), particularly subscription line financing. In last year's "Funds Financing" piece, we discussed the ILP and provided on update on its progress in the Irish market. To date the total number of ILPs registered in Ireland is 36, an increase of 16 on the 20 registered at the time of last year's update. Since the introduction of the Investment Limited Partnership (Amendment) Act 2020, 31 new ILPs have been registered, approximately 30% of which have been advised by the Maples Group, with more ILPs set to launch during the remainder of 2023. Though this is not necessarily a massive uptake, it does reflect a steady stream of new registrations relative to what the rate of new registrations was prior to the legislative overhaul.

Practice Management in Finance Transactions

As a result of new Irish legislative updates and recent Irish case law, we have set out below a summary of some practical considerations for loan documentation in the Irish market.

Piercing the corporate veil

In a recent landmark decision, Powers v Greymountain Management Ltd (In Liquidation) [2022] IEHC 599, the Irish High Court held directors and shadow directors personally liable for funds misappropriated by a company as part of a fraudulent investment scheme. This is the first time that an Irish court has pierced the corporate veil to hold directors personally liable, notwithstanding the well-established principle that a company has a separate legal personality to its members and directors.

Although the court accepted that lifting the corporate veil would only arise in the most exceptional circumstances, this judgment serves as a stark warning to all directors that they must carry out their roles exercising the appropriate control and oversight.

In particular, the decision highlights that directors should never abrogate their duties to shadow directors and should always exercise caution and diligence when dealing with third parties. Furthermore, the granting of a power of attorney by a director to another individual does not discharge the director's duty to oversee actions taken on behalf of the company by that attorney. Directors must also acquaint themselves with the affairs of the company and exercise appropriate supervision and oversight at board level in respect of the discharge of delegated tasks.

As a result of this case, consideration should be given to the insertion in Irish legal opinions of an assumption that no director is disqualified from so acting or subject to any proceedings that might result in disqualification.

SCARP process advisor re solvency

A Process Advisor is an insolvency practitioner appointed to oversee the Small Company Administration Rescue Process, also known as the SCARP, which was introduced by the Companies (Rescue Process for Small and Micro Companies) Act 2021.

The standard banking searches for the purposes of giving an Irish law legal opinion, such as of the Judgment and Petitions Sections of the Central Office of the High Court, would not reveal the appointment of a Process Advisor, as the SCARP procedure was designed to avoid court involvement. The appointment would, however, appear on a Company Registration Office (CRO) Search Report, as the Process Advisor is required to file a notice with the CRO of their appointment and also to advertise a notice in Iris Oifigiúil within two days of their appointment. As a matter of practice, it is therefore advisable (especially for Irish finance lawyers) to check the CRO printout in relation to the company.

Given the current state of the economy, this could be something to watch out for and should be considered when giving legal opinions and drafting the insolvency related provisions (for example, events of default) in the loan agreement.

It was only last autumn that the numbers of SCARPs increased from a tiny handful. It seems that as of early August 2022, only three had been initiated.

Táilte Éireann

Following the Táilte Éireann Act 2022, Táilte Éireann is the new State entity undertaking the functions of the Property Registration Authority (PRA), Ordnance Survey Ireland and the Valuation Office, and was officially launched on 1 March 2023.

Conditions precedents and post-completion requirements in an Irish real-estate financing arrangements should, going forward, refer to registration with "Táilte Éireann" in place of the PRA. Some precedent documents may also require updating.

Conclusion

In the first three quarters of 2023, the Irish banking sector has undoubtedly navigated various challenges both nationally and internationally. Despite these hurdles, the outlook for the remainder of 2023 looks promising as we see the continued strength of NBLs in the market along with an embrace of innovative financial technology. The strong commitment to sustainable finance by both the traditional pillar banks, along with governmental support, shows that the Irish market continues to be adaptable to the ever-changing landscape and will be prepared for the opportunities and challenges that lie ahead.

ISRAEL

Law and Practice

Contributed by:
Irit Roth, Roy Nachimzon, Natalie Jacobs and Ben Kanter
Herzog Fox & Neeman

Contents

Herzog Fox & Neeman is one of Israel's premier law firms and has a reputation as a market leader, thanks to its involvement in major developments that shaped the Israeli economy. Herzog's banking and finance practice is one of the largest and most diversified finance practices in Israel, in terms of both services and clients, and is internationally respected for its "all-encompassing" knowledge of banking and finance in Israel. With an unparalleled edge, the teams have extensive experience handling high-profile, domestic and cross-border cases, as well as complex, cross-departmental cases. Expertise includes all types of loan transactions, acquisition financing, aviation financing, structured financing, regulatory and compliance issues, derivatives, financial products, and more. The firm's practice advises major financial institutions – domestic and international – and represents the majority of foreign banks operating in Israel.

Authors

Irit Roth co-heads the banking and finance department at Herzog Fox & Neeman, and focuses her practice in that area, covering transactional matters and financial services regulation. Irit specialises in banking and financial markets law and regulation, and in market and prudential issues including clearing, settlement, derivatives, asset management, custody, repo, securities lending and prime brokerage, payment services and new technologies. Irit has experience in new product development and regulatory structuring advice, and advises traditional banks and new digital financial providers on various initiatives, often resulting from the reshaping of the financial landscape by digital technologies, as well as the entry of new financial services providers (both local and international).

Roy Nachimzon co-heads the banking and finance department at Herzog Fox & Neeman. He focuses his practice on transactional work and regularly represents banks, institutional investors, private equity funds and corporate borrowers in acquisition finance, commercial loans, restructurings, and other finance transactions. Roy's work includes the representation of both lenders and borrowers, and he has developed substantial expertise in cross-border transactions. Roy also has significant business experience in leadership roles, having previously served as executive vice-president of Global Banking and Finance at El-Ad Group and as senior vice-president and head of the Israeli Desk at Israel Discount Bank of New York.

Natalie Jacobs heads the structured finance and derivatives practice at Herzog Fox & Neeman, and has over 25 years of experience in the areas of banking, structured finance, and derivatives, including swaps, securities financing, ISDA documentation, securitisations and alternative investments. Natalie advises Israeli and international banks, financial institutions and corporations on the broad spectrum of their financial agreements and hedging solutions. Natalie's clients include major banks and financial institutions (international and local), insurance companies and pension funds, investment houses, corporations, investment and fund managers, and financial insurers, both in Israel and abroad. Recently, Natalie led the first listed CLN transaction in Israel, and has advised two Israeli banks on the new securitisation legislation process.

Ben Kanter is a leading cross-border practitioner in Herzog Fox & Neeman's banking and finance department. He specialises in a broad range of banking and finance matters, restructuring and M&A work across various practice sectors, and regularly represents leading global banks, financial institutions, private equity houses, large international and domestic corporations, and high net worth individuals. Ben also specialises in the field of aviation financing, transfers and registrations in Israel, acting principally for foreign purchasers, lessors and lenders. Ben's recent clients include Abu Dhabi Commercial Bank, Altshuler Shaham, Bank Hapoalim, Bank Leumi, Blackstone, BNP Paribas, Carlyle, Citibank, Credit Suisse, Francisco Partners, Goldman Sachs, HSBC, ING, Israel Electric Company, JPMorgan, Macquarie Bank, Morgan Stanley, Phoenix Insurance, Splitit, Superbet, and others.

Herzog Fox & Neeman

Herzog Tower
6 Yitzhak Sadeh St
Tel Aviv 6777506
Israel

Tel: +972 3 692 2020
Fax: +972 3 696 6464
Email: Rothi@herzoglaw.co.il
Web: herzoglaw.co.il/en/

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

The increasing interest rates and difficult credit conditions are currently driving some of the more leveraged companies to seek alternatives (such as equity investments) or to attempt to restructure loans (eg, by way of deferrals, payment extensions or facility increases). Lenders are generally offering more conservative terms and raising their credit qualifications. Licensed and exempt credit providers are offering alternatives to traditional lenders, but currently their market share remains low.

1.2 Impact of the Ukraine War

The impact of the Ukraine war has been minimal. As in other jurisdictions, Russian lenders have not been active in the local lending market since the breakout of the war.

1.3 The High-Yield Market

The local high-yield market is undeveloped. Accordingly, it is difficult to state how it may have affected financing terms and structures in Israel. The market has seen some funded derivative transactions that are backed by securities as a means of providing financing.

1.4 Alternative Credit Providers

The loan market in Israel has seen significant rapid growth in alternative credit providers in the last few years. This growth is attributable to institutional lenders, as well as to non-bank lenders that are acting under a lending licence. These lenders are very active in the retail market, offering mortgages, car loans and loans for general purposes.

A trend in the lending market in recent years is sales of loan portfolios, largely from the lending institutions to the institutional investors.

According to publicly available information, as of March 2023 the main components of the local non-bank credit are corporate bonds (tradable and non-tradable) and institutional loans, which amount to approximately NIS282 billion and approximately NIS100 billion, respectively.

The authors are of the opinion that non-bank lending has not affected financing terms and structures in a meaningful way.

Following interest rate hikes and the more attractive interest rates that are offered by Israeli banks on deposits, there has been a spate of recent cases concerning non-institutional non-bank lenders entering into insolvency or default scenarios; therefore, there is growing negative market sentiment regarding such lenders.

1.5 Banking and Finance Techniques

In the context of leveraged financing and the acquisition of Israeli targets, foreign borrowers appear to be leaning towards HoldCo structures familiar to them in other jurisdictions. This enables purchasers to obtain acquisition debt from foreign credit providers using a structure they recognise. Using derivatives as an alternative to secured financing has also been a recurring theme over the past few years.

Other trends seen in the market include sales of debt portfolios by Israeli banks, as well as by non-bank lenders. These sales are either direct true sale sales to a specific institutional entity, or a sale to a special purpose company, that issues notes to institutional investors or receives a loan from a local bank to finance the purchase of the portfolio. Repayments of the loans in the portfo-

lio are then passed through to the note holders or financing entity.

An additional structure used by banks to obtain capital relief is a CLN or a fully funded CDS backed by cash.

In light of the publication of a draft securitisation law and amendments to the Israeli tax ordinance with respect to securitisations, more traditional tranched securitisation structures in Israel will hopefully emerge.

1.6 ESG/Sustainability-Linked Lending

ESG remains a developing topic in Israel. One of Israel's largest banks recently entered into a large credit line agreement with the European Investment Bank to support "green" investments, and it is expected that ESG will continue to become more relevant in the medium-term.

2. Authorisation

2.1 Providing Financing to a Company

The Supervision of Financial Services (Regulated Financial Services) Law, 5766-2016 sets out a comprehensive regulatory framework for credit providers (among others), and requires that credit providers obtain a licence to lend in Israel (certain criteria has been published as to the territorial scope of the law and what would be deemed to be lending in Israel). This is subject to certain available exemptions, including for OECD-licensed banks and certain other OECD-regulated entities and their subsidiaries (which are regulated for anti-money laundering in their home country), as well as for large loans to business entities.

Subject to the above, banks may lend to Israeli companies on a cross-border basis.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Foreign lenders may provide loans if they or the loan transaction meet the requirements under one of the relevant exceptions (see **2.1 Providing Financing to a Company**). To the extent licensing is required, currently only Israeli entities may obtain a licence to lend in Israel. Foreign banks may request a foreign bank licence without incorporating a local subsidiary, subject to certain requirements and criteria.

3.2 Restrictions on Foreign Lenders Receiving Security

Generally, there are no restrictions or impediments to providing security or guarantees to foreign lenders or security agents, although receiving a security interest over shares in certain regulated companies or in companies subject to foreign holding restrictions may require a permit, and may not be possible when exceeding a certain percentage of the equity in the company.

Additionally, loans secured by intellectual property developed with funding from the Israel Innovation Authority (IIA) require foreign lenders or security agents to execute an undertaking towards the IIA, agreeing that enforcement of the security will be made in Israel and subject to the Law for Encouragement of Research and Development in Industry – 1984 (as amended).

Registration of mortgages in the Israel Land Registry in the name of foreign lenders or security agents may require translation of documents into Hebrew and the delivery of legal opinions – this can be a drawn-out process.

3.3 Restrictions and Controls on Foreign Currency Exchange

Israel does not currently have any currency controls in place with non-sanctioned jurisdictions.

3.4 Restrictions on the Borrower's Use of Proceeds

A borrower may not use loan proceeds for any illegal or sanctioned activity. Otherwise, to the authors' knowledge, there are no restrictions.

3.5 Agent and Trust Concepts

A trust is a recognised concept under Israeli law. No parallel debt structure is required under Israeli law.

3.6 Loan Transfer Mechanisms

Generally, loans can be freely assigned in Israel, unless a restriction is in place in the loan documents or by law (applicable mostly to loans secured by assets that are regulated or that require a permit). The assignee should be licensed to lend, or be exempt from the licensing requirement (see **2.1 Providing Financing to a Company**). Upon assignment of the loan, any collateral provided (to the extent it is transferrable) is also transferred as matter of law, although registration in order to perfect the assignment may be required.

3.7 Debt Buy-Back

Debt buy-back is permitted in Israel, unless contractually restricted pursuant to the underlying documentation. Where such debt is a listed bond, additional rules apply pursuant to relevant securities regulation.

3.8 Public Acquisition Finance

There are no specific provisions in Israel catering for "certain funds", beyond basic contractual principles. The concept is less developed in Israel than in other jurisdictions.

3.9 Recent Legal and Commercial Developments

The most recent law which required changes to legal documentation was Israel's Insolvency and Economic Rehabilitation Law – 2018 (the "Insolvency Law") which came into effect on 15 September 2019. Certain changes were made to ensure that the updated suite of Israeli insolvency proceedings and procedures were reflected, as necessary.

3.10 Usury Laws

Under the Israel Interest Law – 1957, the maximum rate of interest which may be charged on index-linked loans lent in new Israeli shekel is 13% per annum, and the maximum rate of arrears interest is 17% per annum. Additional restrictions apply to compounding of interest.

Under the Fair Credit Law (which applies to loans to individuals not exceeding approximately NIS1.2 million), the maximum rate of interest which may be charged on unindexed-linked loans is as follows:

- on unindexed new Israeli shekel loans, the Bank of Israel Rate + 15% per annum, and if in arrears, the Bank of Israel rate + 18% per annum; and
- on foreign currency loans, the London Inter-Bank Offered Rate (LIBOR) + 15% per annum, and if in arrears, LIBOR + 18% per annum.

Additionally, there is some case law on this topic, particularly as regards overly excessive interest rates; however, there are no strict rules other than as described above.

3.11 Disclosure Requirements

Companies which have listed equity or debt are required to report material financial contracts

to the public. The Israeli Securities Authority has published rules pertaining to the information required to be reported in respect of significant credit agreements, both in immediate reports (upon entry into the contract, any material change thereto and in default scenarios) and in financial statements.

4. Tax

4.1 Withholding Tax

Interest payments, and payments deemed to be interest payments (eg, discounts upon conversion of a convertible loan security) paid by Israeli borrowers are subject to withholding tax at source, currently at a rate of 23% for corporate (opaque) lenders. A reduced withholding rate may be available under an applicable tax treaty; however, this requires receiving written confirmation from the Israel Tax Authority ahead of making such payment, subject to the lender meeting the relevant eligibility criteria under said treaty.

A recent amendment to the law, which was adopted with the goal of strengthening the Israeli high-tech industry, has (among other reliefs) introduced a tax exemption for interest paid by a high-tech company to a foreign financial institution, subject to meeting certain detailed conditions.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Interest payments may also be subject to value added tax (VAT), currently levied at a rate of 17%. Typically, the local borrower entity would be required to issue a self-invoice (a reverse-charge mechanism). Depending on the use of the borrowed funds, the VAT may be reclaimable.

There is currently no stamp tax or similar documentary tax payable in Israel in respect of credit transactions.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

As noted previously (see **4.1 Withholding Tax**), withholding of taxes occurs at source, which can be mitigated by gross-up provisions in the loan documents.

In addition, and depending on the nature and scope of the activities of the foreign lender and whether or not personnel present in Israel are involved in the origination of the loan, there could be permanent establishment issues relating to the foreign lender which would, in parallel, trigger tax reporting and other compliance issues.

5. Guarantees and Security

5.1 Assets and Forms of Security

Forms of Security Available in Israel

Israeli law recognises both fixed and floating charges.

Assets capable of being secured by way of fixed charge include:

- shares;
- patents;
- trade marks;
- real estate;
- equipment;
- machinery;
- receivables; and
- any other specific asset of the company.

Israeli law is unclear as regards creating a fixed charge over future collateral, although the pre-

vailing market view appears to be that this is not possible.

A floating charge may also be created by an Israeli company over a specific asset or over all present and future assets of the company.

To the extent that an Israeli court deems that an asset purported to be charged way of fixed security does not meet the necessary criteria for fixed security (eg, identifiability and lender control of the asset), the security may be classified as a floating charge instead.

Formalities and Perfection Requirements

Under Israeli law, the laws that govern the perfection of a security interest are the laws of the jurisdiction of incorporation of the pledgor (ie, the State of Israel) and the laws of the jurisdiction where the charged property is located or deemed located. Accordingly, in order to ensure the validity, binding effect and enforceability of a security interest against a third party or liquidator of an Israeli company, it is necessary to:

- file the security agreement at the Israeli Companies Registry within 21 days of execution of the security agreement, and an executed Hebrew language statutory form; and
- comply with all registration/perfection requirements of the jurisdiction where the charged property is located or deemed located (if different from Israel).

Similarly, in order to ensure the validity, binding effect and enforceability of a security interest against a third party or liquidator of an Israeli partnership or individual, it is necessary to:

- register the security interest at the Israeli Pledges Registry by way of an executed Hebrew language statutory form; and
- comply with all registration/perfection requirements of the jurisdiction where the charged property is located or deemed located (if different from Israel).

Failure to perfect a security interest would result in the security interest not being valid vis-à-vis other creditors or a receiver or insolvency official, and the creditor would therefore be unsecured.

Costs of perfection are minimal (less than USD100) and, in the authors' experience, charges and pledges are registered at the relevant registry within two to five business days.

5.2 Floating Charges and/or Similar Security Interests

It is possible for an Israeli company to charge future assets under a floating charge. As previously discussed, it is likely not possible to create a fixed charge over future assets.

Israeli partnerships and individuals are unable to create floating charges.

Israeli companies are permitted to create floating charges, which may cover a pool of assets.

5.3 Downstream, Upstream and Cross-Stream Guarantees

There must be independent corporate benefit in providing any third-party guarantee or security interest to a lender. Typically, this is easier to identify in the case of downstream credit support.

In the context of upstream and cross-stream guarantees, the Israeli credit support provider must carefully consider whether adequate corporate benefit is present. It is arguable whether this may be managed with a fee payable to the

Israeli security provider to the sister company or parent, or whether such a fee assists in any way.

If no corporate benefit is present, any guarantee given to a sister company, or to a company with common owners, falls within the (wide) definition of a distribution. For the distribution to not be unlawful, it must meet the relevant distribution tests (see **5.4 Restrictions on the Target**). Generally, even if sufficient profits are available to pay under the guarantee, existing third-party creditors (ie, employees, tax authorities, trade creditors, etc) could still seek to prevent payment under the guarantee for reason of lack of corporate benefit.

5.4 Restrictions on the Target

In the context of an acquisition, without an application to court for a capital reduction, the effect is that any security or financial assistance granted by the target (including upstream guarantee or security granted by an Israeli entity as part of an acquisition financing package for the purchase of its shares or the shares of its parent) must meet certain distribution criteria (and is treated as a distribution). These criteria are as follows.

Profits Test

Dividends may be distributed only out of the greater of:

- the balance of accumulated reserves; and
- reserves/profits accumulated over the two most recent fiscal years based on the company's most recent financial statements (audited or reviewed).

For calculation purposes, the aggregate amount of all previous distributions is deducted (other than distributions which were already subtracted from the company's retained earnings as reported in its financial statements). The date of the distribution may not exceed six months from the end of the period to which such financial statements relate.

Solvency Test

A distribution may only be effected when there is no reasonable suspicion that the distribution will result in the company being unable to meet its current or future obligations when due. This subjective determination as to whether or not the company satisfies the solvency test is made by the company's board of directors.

Although the law is not entirely clear on this point, there is an argument that both above-mentioned tests should be met at the time of creation of the guarantee as well as at the time of any enforcement. Therefore, unless both tests are met, any support by the Israeli company or its subs to the acquisition (including the granting of collateral or upstream guarantees) may constitute a prohibited distribution.

To bypass this limitation, it is possible to apply to the court and ask for a capital reduction irrespective of the company not meeting either test or both tests; however, this can be a long process and is rarely used.

Another possible approach is merging a newly established Israeli acquisition vehicle into the target, thereby pushing the debt into the target. The rationale for using this structure is that the merger procedure has its own built-in protections for creditors of the target, and therefore there is no need to also meet the distribution tests. A number of transactions have been structured in this manner; however, there are no court cases that either support or reject this approach, and thus there is some uncertainty involved with it.

In the context of acquisition financing, it is common to see the credit support provided by an Israeli target being limited to its distributable reserves as available at the time.

Note that there is no issue with pledging the shares of the Israeli target in support of the acquisition financing, and this is almost always done.

5.5 Other Restrictions

Generally, the granting of guarantees or security may be restricted for a regulated entity, in accordance with any statutory restrictions or limitations included in any licence granted to it.

To the extent an Israeli pledgor has received government funding (eg, from the IIA), statutes and conditions concerning such funding may also include restrictions on pledging.

Any underlying contractual restriction on pledging an asset may also be relevant.

5.6 Release of Typical Forms of Security

In order to release a security interest in Israel, it is necessary to file a standard discharge in Hebrew to:

- the Companies' Registry if the security interest is registered in the name of a company; or
- the Pledges Registry if the security interest is registered in the name of a partnership or individual.

5.7 Rules Governing the Priority of Competing Security Interests

Under Israeli law, in order to have priority against a third party or liquidator of an Israeli company or partnership, the security interest must first be registered at:

- the Israeli Companies Registry (for companies); or
- the Israeli Pledges Registry (for partnerships and individuals).

See **5.6 Release of Typical Forms of Security**.

If duly registered, the priorities between creditors will generally be determined based on the "first in time" principle. If a registered floating charge also contains a negative pledge notation, this security interest will generally take priority over any subsequent security interest created over the same asset, including fixed security.

Generally, a creditor with a fixed-charge security interest will have priority over all other creditors for all outstanding obligations, except that from the date the court issues a commencement-of-proceedings order, default interest accruing on outstanding obligations will be subordinated to unsecured debt.

For floating charges created on or after September 2019, the Insolvency Law provides that a floating charge holder will be entitled only to 75% of the proceeds of realisation of the assets that were subject to the floating charge on the date of commencement of the insolvency proceedings after statutorily preferred payments (such as realisation expenses, unpaid employee salaries, severance pay and certain taxes). Any remaining debts owed to the floating charge holder after such payment will rank pari passu with the unsecured creditors.

In addition to the above, from the date the court issues a commencement-of-proceedings order, default interest accruing on outstanding obligations will be subordinated to unsecured debt.

Contractual subordination is common in Israel, and priority can be and regularly is contractually varied in a lender group or between two separate groups of lenders.

Contractual subordination provisions should also survive an Israeli insolvency. This is likely to be relevant at a level above the insolvent entity once the court-instructed distributions have been finalised post-insolvency.

5.8 Priming Liens

A trustee will have discretion to negotiate and accept terms for DIP financing to fund the business and to support a going-concern sale where such financing is essential for the economic rehabilitation of the debtor (conditional upon obtaining court approval). The trustee may agree with the secured lenders on the terms for DIP financing that requires a sales process, though this outcome is not assured and depends on the trustee's judgement under the circumstances and the obtaining of court approval.

A trustee may seek alternatives for DIP financing other than the existing secured lender. The legal standard for obtaining such DIP financing is that existing secured lenders should receive adequate protection or other means to secure their interests. There is limited guidance on the standards for adequate protection without the consent of the existing secured lender.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Generally, a lender may enforce its collateral upon the occurrence of any of the trigger events agreed in the relevant security document.

Outside insolvency proceedings, the lender may enforce its security through the Israeli courts (or the Israeli court execution office) with a sale conducted by a receiver, often through a public auction.

In the context of insolvency proceedings, the court may determine whether to direct the company or partnership into rehabilitation or liquidation proceedings.

An applicant for an order for commencement of proceedings is able to specify its preference for rehabilitation or liquidation; however, the court will ultimately decide which route to direct the company or partnership towards (ie, rehabilitation or insolvency), based principally on the economic condition of the company or partnership.

If the court proceeds to order the company or partnership into rehabilitation proceedings, the court has the right to order a moratorium on proceedings against the company or partnership for up to nine months (extendable by successive periods of up to three months each), which may restrict the enforcement of security. During this moratorium, the court may permit a holder of a fixed or floating charge to enforce or crystalise its security, if it is satisfied that:

- adequate protection of the secured creditor's rights cannot be guaranteed (determined principally on economic grounds); or
- enforcement of the security interest would not jeopardise the creditor's arrangement (principally determined based on an analysis of whether enforcement would affect the operation of material elements of the business).

If the court proceeds to order the company or partnership into liquidation proceedings, the moratorium on proceedings against the com-

pany or partnership will not apply to secured creditors.

6.2 Foreign Law and Jurisdiction

Generally, a choice of foreign law as the governing law of the contract, the submission to a foreign jurisdiction and a waiver of immunity would be upheld in Israel, subject to:

- Israeli principles of public policy (including, without limitation, the principles applicable to government contracts);
- mandatory rules of Israeli law (including good faith); and
- the Israeli rules of civil procedure.

6.3 Foreign Court Judgments

Generally, subject to any jurisdiction-specific agreement, any monetary judgment obtained in a foreign court will be enforceable in the courts of Israel without re-trial or re-examination of the merits of the case provided certain requirements are fulfilled in accordance with the Enforcement of Foreign Judgments Law, 1958 (the "Foreign Judgments Law") – the principal conditions of which are that:

- the judgment has been rendered by a foreign court, which under the laws of the foreign jurisdiction was competent to render the judgment;
- the foreign judgment is final and not subject to appeal, and an appeal is no longer possible (or that an appeal was rejected and no further appeal is possible);
- the obligation imposed by the foreign judgment is of a type enforceable under the rules of enforcement of judgments in Israel;
- the content of the foreign judgment does not contradict Israel's public policy;
- the judgment is capable (as a legal matter) of being executed in the jurisdiction where the judgment was made;
- Israeli courts will only declare a judgment given in a particular country as enforceable in Israel if the courts of that country would likewise enforce a judgment given by an Israeli court;
- the judgment must not have been obtained by fraud, or in a manner contrary to principles of natural justice or international law; and
- a motion for the enforcement of a foreign judgment must be filed within five years from the date the foreign judgment was rendered, unless there is an agreement between Israel and the country in which the judgment was delivered stipulating an alternative period of time (or unless certain other special circumstances exist).

Regarding foreign arbitral awards generally:

- any award of an arbitral tribunal made following an arbitration conducted in accordance with the requirements of standard arbitration provisions will be enforceable in the Israeli courts pursuant to Israeli arbitration law in accordance with, and subject to, the terms of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 Convention (the "Convention"); and
- if any party were to commence legal proceedings in the Israeli courts in relation to any matter covered by the arbitration provisions, the Israeli courts will, pursuant to and subject to the exceptions and provisions of the Israeli Arbitration Law and of the Convention, stay such proceedings and require the dispute to be submitted to arbitration in accordance with the applicable arbitration provisions (an interim relief may be granted by Israeli courts).

The arbitration provisions will need to be reviewed on a case-by-case basis.

6.4 A Foreign Lender's Ability to Enforce Its Rights

To the extent that the Israeli entity is regulated or the secured asset has been government-funded, please see earlier in **5. Guarantees and Security** and **6. Enforcement**. However, to the authors' knowledge, no other matters would affect a foreign lender's ability to enforce its rights under a loan or security agreement.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

See **6.1 Enforcement of Collateral by Secured Lenders** regarding rehabilitation and liquidation proceedings.

7.2 Waterfall of Payments

The general principle that applies to the allocation of assets (or the proceeds of the sale of assets) of an insolvent company or partnership is that all creditors should be treated equally (and thus receive a pro rata return with respect to their debts). However, this principle is overridden by a series of statutory provisions such that, in general, the priority of creditors may be summarised as follows:

- holders of a statutory first charge (largely in respect of certain unpaid taxes);
- creditors secured by a fixed charge (other than for amounts representing default interest which are subordinated to unsecured debt);
- costs of insolvency proceedings;
- creditors who enjoy statutory preference (such as for certain unpaid taxes);
- creditors secured by a floating charge (other than for amounts representing default interest which are subordinated to unsecured debt) (subject to as discussed in **5.1 Assets and Forms of Security**); and
- unsecured creditors.

7.3 Length of Insolvency Process and Recoveries

An insolvency process may take as little as a few months or up to any number of years. There is no uniform answer, and the following factors are all relevant:

- the complexity of the insolvency proceedings;
- the volume of objections submitted (if any);
- the number of petitions filed; and
- the type of proceedings.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

The Insolvency Law introduced a temporary measure of protected negotiations for listed companies outside insolvency proceedings; however, to the authors' knowledge, this has not been used.

Further, a temporary measure of postponement of proceedings was introduced as a result of the COVID-19 pandemic, with the effect of rehabilitation (see **6.1 Enforcement of Collateral by Secured Lenders** regarding rehabilitation proceedings), though allowing a company to continue and manage its affairs without the appointment of an insolvency official. Additional available procedures include court-approved debt arrangements, allowing a company to reorganise its debt with all creditors.

7.5 Risk Areas for Lenders

If the borrower, security provider or guarantor were to become insolvent, the main risk areas for lenders centre around the ability to enforce contractual rights and security. Once insolvency

proceedings commence, the insolvency process is managed by a court-appointed trustee and is supervised by the court. This may entail stay of proceedings and limitations on the ability to enforce security.

8. Project Finance

8.1 Recent Project Finance Activity

The most active sectors in recent years have been:

- energy (particularly renewable energy and storage);
- light rail;
- desalination; and
- military infrastructure.

8.2 Public-Private Partnership Transactions

PPP structures in Israel are similar to those in other jurisdictions, although State/private sector risk allocation is perhaps more favourable to the State.

There is no general PPP legislation in Israel – rather, specific sectors have specific legislation governing projects in that sector (eg, the Electricity Sector Law and rules issued by the sector regulator govern the electricity sector).

Most PPP projects are conducted within the scope of a concession agreement issued by the State as part of a mandatory tender process, and this tender law plays a significant role in the selection of the private sector entity. However, in the electricity sector, in some cases a licence and/or quote regime is in effect, with general rules being applicable rather than a project-specific concession agreement.

8.3 Governing Law

Typically, the concession agreement issued by the State will be governed by Israeli law; in certain cases, disputes will be resolved by Israeli arbitration, though Israeli court jurisdiction is more common.

Given the need for back-to-back assumption of responsibility, EPC and O&M contracts will also typically be governed by Israeli law. Offtake/PPA agreements will also usually be governed by Israeli law. However, major equipment supply contracts (such as for turbines and light rail vehicles) have sometimes been governed by other laws.

On the finance side, it is more acceptable for agreements with non-Israeli lenders to be governed by English or New York law.

8.4 Foreign Ownership

Usually, tender documents for major PPP projects impose restrictions requiring that the owners be incorporated in countries which maintain diplomatic relations with the State of Israel. In certain cases, ownership of a PPP project by a non-Israeli entity may require the ad hoc approval of a committee run by the Prime Minister's officer, which addresses concerns similar to those addressed by the CFIUS regime in the USA.

Although PPP projects do not usually involve ownership of real property rights (but rather a long-term right of use), non-Israeli ownership of real estate in Israel is subject to an approval process.

Provided that the lenders meet the criteria for lenders set out in the tender documents/concession agreement (again, usually regarding incorporation in a country with which Israel has

diplomatic relations), there are generally no specific issues with receiving and enforcing security interests (although it is common to use a local entity as a security agent, especially where an Israeli bank is a co-arranger).

8.5 Structuring Deals

In most cases of large-scale PPP projects, the concession agreement will require the concessionaire to incorporate as an Israeli limited company (though in some cases, it may allow for a limited partnership). In the electricity sector where the licence/quota regime applies rather than a concession agreement, the most common structure is to use a limited partnership (for tax reasons).

There are no specific laws regarding structuring of project companies as opposed to other types of companies (although the accounting treatment of PPP projects may be different).

8.6 Common Financing Sources and Typical Structures

For the most part, project finance is arranged by one or more local or international banks who organise a syndicate of mainly Israeli lenders (usually made up of institutional entities – pension/provident funds, insurance companies, etc). Rules that govern these entities (referred to as the "Goldschmidt" rules) require them to ensure that certain conditions be included in the finance documents, including:

- minimum holding by the arranger of 10% of the debt;
- full disclosure by the arranger of any actual or potential conflicts of interest;
- disclosure by the arranger of the types of fees it receives; and
- receipt of all information received by the arranger as part of its work.

ECA financing has been used in a number of cases where key equipment is manufactured in the relevant jurisdictions (mainly turbines and light rail vehicles), though it is still not common.

Project bonds, private equity financings and similar structures are not common sources of senior debt in Israel (though Israeli infrastructure funds have provided mezzanine financing or equity in a number of projects).

8.7 Natural Resources

Other than renewable energy sources, Israel's main natural resource is natural gas. Exploration, extraction, transmission, distribution and sale of natural gas is highly regulated:

- upstream is regulated by the Petroleum Commissioner, under the Petroleum Law 1952 and associated regulations and rules; and
- midstream and downstream is regulated under the Gas Sector Law and associated regulations and rules.

Under the relevant legislation, each natural gas lease has local supply obligations determined by the regulator (although a certain amount of trade in these obligations is possible). Exportation of gas (within the export quota) is also subject to approvals regarding the identity of the counterparty.

Generally speaking, Israel's electricity grid is an "island" and is not connected to its neighbours; therefore, the exportation of electricity is not possible.

8.8 Environmental, Health and Safety Laws

In Israel, the key regulatory bodies overseeing finance and investment policies are:

- the Capital Market Authority (CMA); and
- the Supervisor of Banks at the Bank of Israel.

While there are no specific regulations regarding financial projects, there are several policies and regulations for financing and investment related to ESG, including as follows.

ESG Disclosure Requirements

Currently, Israel does not have mandatory ESG disclosure laws. As a result, the degree of ESG disclosures varies between institutions, with some taking a more proactive approach than others. The CMA mandates that financial institutions disclose their incorporation of ESG factors in their investment policies. Additionally, several institutional investors utilise ESG questionnaires and rely on external ratings for responsible investments. Investors and asset managers enjoy flexibility in their approach to considering ESG factors.

Environmental Risk Management

Israeli banking institutions are obligated to identify and manage environmental risks in their lending, financing and investment activities. They must establish and implement "environmental risk-management programmes", often involving the assessment of ESG reports or ratings, which can be provided by the issuer or external service providers.

It should be noted that practice is also to review material environmental permits (if needed) for the activity that is relevant to the financing – for example:

- air emission permit under the Clean Air Law;
- toxins permit under the Hazardous Substances Law; and
- business licence under the Business Licensing Law.

In addition, tests of soil and water pollution are often considered in the financing of a project.

ITALY

Law and Practice

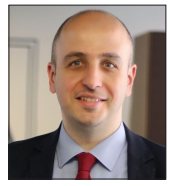
Contributed by:
Francesco Dialti, Emanuele Caretti and Vincenzo Cimmino
CBA

Contents

CBA is an independent Italian law firm with more than 120 professionals operating across five offices; its international vocation has strengthened over the years through the expertise of its professionals and strong worldwide relationships. CBA advises its clients on the full range of finance transactions, these include corporate lending, real estate financing, acquisition finance, project finance, structured finance (credit transfers and securitisation), alternative financing and shipping finance. On the lender side, it has developed strong relationships with Italian and foreign lenders, which are increasingly using the firm's legal services. On the borrower side, CBA advises major Italian and foreign companies, with a strong focus in the shipping and in the energy sectors. A major part of the firm's work in this area is cross-border.

Authors

Francesco Dialti heads the banking and finance department of CBA. He mainly advises domestic and international banks on banking law and asset finance. His experience also includes advising financial institutions, corporates and investors on real estate finance, project finance, asset finance (with a special focus on transactions made in the field of port sector and shipping, and M&A transactions), and structured finance. Francesco is a fellow member of the International Bar Association (IBA), where he is vice-chair of the Talent and Leadership Subcommittee.



Emanuele Caretti joined CBA in August 2020 as a senior associate. Prior to joining CBA, he spent over 10 years working for leading Italian and international law firms in Italy and in United Kingdom. At CBA, he mainly advises domestic and international banks as well as corporates, sponsors and investors on banking, real estate finance, project finance, structured finance and securitisation. He is author of publications in the field of the shipping finance. Emanuele is admitted to the Italian Bar and is a fellow member of the International Bar Association (IBA).

Vincenzo Cimmino joined CBA in May 2017 and was appointed senior associate in 2019. Prior to joining CBA, he spent over 10 years working for leading Italian and international law firms. At CBA, he mainly advises domestic and international banks as well as corporates, sponsors and investors on banking, real estate finance, project finance, structured finance and securitisation. He is author of a number of publications in the field of securities law published in domestic magazines. Vincenzo is admitted to the Italian Bar and is a fellow member of the International Bar Association (IBA).

CBA

Corso Europa
15 Milano
Italy

Tel: +39 02 778061
Fax: +39 02 76011020
Email: milano@cbalex.com
Web: www.cbalex.com/en

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

In 2023 the Italian loan market, like other European loan markets, has experienced a limited slowdown mainly due to increase in interest rates, which is only partly connected to the war in Ukraine but mostly reflects a more general trend in European economies. This has had an impact, in particular, on real estate finance deals, as increased interest rates reduce the profitability of leveraged deals.

The mid-size acquisition finance sector has remained very active, while there has been reduced activity in the large acquisition sector.

There has also been a sizeable wave of bridge loans, which will most likely be refinanced upon decrease of the interest rates.

Lastly, project finance remains a very hot topic, in line with global trends fostering energy transition.

1.2 Impact of the Ukraine War

The military aggression by Russia against Ukraine caused disruption at the beginning of 2022, not only for companies active in that region, but for the whole Italian economy, especially in the light of gas supply issues with Russia.

However, the loan market was not excessively impacted; this was partly thanks to actions by the Italian government, including:

- at a political level, the execution of agreements with other states for the supply of oil and gas to replace that of Russia; and
- increased push for guarantees provided by SACE and the Central Guarantee Fund.

1.3 The High-Yield Market

The high-yield market continues to grow at a steady pace.

However, it is still a secondary source of financing.

One reason for this is the cost connected to implementing a structure of the type typically used for these transactions, where the private placement documentation is governed by New York law.

This increases the transaction costs and requires a significant minimum issue amount to be efficient.

1.4 Alternative Credit Providers

In order to increase the competitiveness of the Italian lending market, a number of developments have been introduced by the Italian legislator in the last ten years, including:

- new players have been given access to the lending market by including them among the entities licensed to carry out lending activities in Italy;
- non-listed companies have been given access to bond financings; and
- the tax regime has been made more favourable by extending the application of certain tax benefits.

This gave rise to an alternative market to the banking one (especially in the acquisition finance sector).

To date, new players have been mostly active in mid-sized deals. They often provide a mezzanine/subordinated tranche to fill the gap between the maximum leverage ratio allowed by

senior (bank) lenders and the financing needs of private equity sponsors.

1.5 Banking and Finance Techniques

Due to principle of reserve of activity see below) an alternative structure used by all foreign funds for the purchase of receivables (which is also reserved activity; see below) in Italy is the establishment of an Italian SPV, incorporated under Italian Securitisation Law (Law No 130/1999), which issues notes subscribed to by the investor(s).

The funding structure of an Italian law securitisation transaction is very flexible; it entails an investment made through the subscription of asset backed securities (which can be also be issued in different tranches or classes) and may also involve, under certain requisites, the granting of loans.

As an alternative to direct lending, a possible structure (which is being used more and more frequently) is the subscription by investors of bonds issued by Italian companies.

Historically, the issuance of bonds by Italian companies was subject to many legal requirements.

Since Law Decree No 83 of 2012, which first introduced the "mini bond" instrument in the Italian legal framework, the situation has dramatically improved.

Originally, the new instrument was intended to mainly be used to boost the growth of companies which did not have access to the traditional banking credit, however the development of specialised players has made this instrument very popular in the Italian market.

1.6 ESG/Sustainability-Linked Lending

In line with the growing global demand for sustainable finance, there has been an increase in ESG or sustainability-linked financing transactions in Italy in recent years.

ESG metrics are, in particular, taking a major role both in the financial risk valuations and in the remuneration of the risk capital: a discount on the margin levels is granted to those companies which meet some ESG target metrics.

2. Authorisation

2.1 Providing Financing to a Company

In the Italian legal system, as opposed to other legal systems, the principle of reserve of financing activity applies. This principle is established in Article 106, paragraph 1, of Legislative Decree No 385/93 (the "Consolidated Banking Law"), which reserves the exercise of financing activity in any form, in addition to banks, to authorised financial intermediaries registered with a special register held with the Bank of Italy. A breach of this provision will also be punished under Italian criminal law.

However, in recent years, changes to the regulatory and tax framework have been implemented to allow financing alternatives to the traditional bank financing model, so that insurers, Italian securitisation vehicles (ie, companies established pursuant to the Italian Securitisation Law) and alternative investment funds may also engage in direct lending to Italian borrowers.

Pursuant to Article 106, paragraph 3 of the Consolidated Banking Law, the Minister for the Economy and Finance, having consulted with Bank of Italy, shall specify the content of the lending activities, as well as the circumstances

in which they are deemed to be carried out vis-à-vis the public.

In this regard, the Decree of the Ministry of Economy and Finance No 53 of 2 April 2015 (Regulation containing rules for financial intermediaries in the implementation of Article 106, paragraph 3, 112, paragraph 3, and Article 114 of Legislative Decree No 385 of 1 September 1993, as well as Article 7 ter, paragraph 1 bis, of Law No 130 of 30 April 1999) (the "Decree") is relevant.

The Decree has implemented an extremely broad notion of lending activities.

Article 2 of the Decree (Granting of financing activities in any form) provides as follows:

"1. The activity of granting loans in any form means the granting of credit, including the issuance of guarantees and credit agreements for the issuance of guarantees towards third parties. This activity includes, inter alia, any type of financing granted in the form of:

(a) financial leasing;
(b) purchase of receivables for a consideration;
(c) consumer credit as defined in Article 121 of the Consolidated Banking Law;
(d) lending secured by a mortgage;
(e) lending secured by a pledge;
(f) issuance of personal guarantees, bankers' drafts, documentary credits, acceptances, bank endorsement, undertaking to grant credit, as well as any other form of guarantees and commitments to issue guarantees."

In relation to the authorisation necessary to grant financing and to perform other banking activities, the Bank of Italy shall assess the existence of certain conditions to ensure the sound and prudent management.

In particular, the following requirements must be fulfilled:

- incorporation in the form of a joint stock company;
- a registered office and headquarters in Italy;
- minimum share capital of EUR10 million (or higher if required due to the activities envisaged in the relevant programme of activities);
- submission of the deed of incorporation together with the by-laws and a programme of initial activities;
- shareholders meeting certain requirements provided by law; and
- directors meeting certain eligibility criteria provided by law.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

The exercise of financing activity in Italy, in any form, is reserved for banks and authorised financial intermediaries registered with a special register held with the Bank of Italy.

Additionally, the EU passporting regime entitles a bank that is regulated in one EU member state to carry out banking activities recognised under the EU passporting regime in other EU member states.

The passporting regime does not cover unregulated lenders or investment firms that wish to undertake lending activities in Italy on a cross-border basis.

3.2 Restrictions on Foreign Lenders Receiving Security

There are no restrictions on foreign lenders benefiting from security or guarantees governed by Italian law.

However, if the financing is not subject to *imposta sostitutiva* (so-called substitute tax), which is dealt with at **4.2 Other Taxes, Duties, Charges or Tax Considerations**, substantial registration taxes, depending on the nature of the security and the features of the facility agreement, may apply.

3.3 Restrictions and Controls on Foreign Currency Exchange

Italy has no foreign exchange controls.

Restrictions may apply with respect to transactions involving specific countries (eg, countries with respect to which international sanctions apply), but in principle there are no restrictions on currency transfers.

Banks are required to report any transaction exceeding thresholds provided for by law due to money laundering and terrorism financing concerns.

3.4 Restrictions on the Borrower's Use of Proceeds

There are no general restrictions on the use of proceeds from loans or debt securities for an Italian borrower, other than financial assistance limitation (see **5.4 Restrictions on the Target**) and the financing of criminal activities.

3.5 Agent and Trust Concepts

Agent Concept

The agent concept exists under Italian law.

In particular, a *mandato* is an agreement under which a party undertakes to execute one or more legal acts on behalf of another party. If the *mandato* is with *rappresentanza* those acts will be executed in the name of the other party (as if that party were executing the deed itself).

Trust Concept

Even if Italy ratified the Hague Convention on the Law Applicable to Trusts and on their Recognition 1985 (the Hague Trusts Convention) through Law No 364/1989, according to which foreign trusts are recognised in Italy and can be regulated by the law chosen by the settlor, Italian law does not discipline trusts.

Italian Law and Practice

Under Italian law, security must be granted to, and perfected in favour of, each creditor individually.

In syndicated loans, secured creditors appoint an agent on the basis of *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.

As an exception to the foregoing, Article 2414-bis of the Italian Civil Code (relating to the issuance of bonds by joint stock companies) provides that all kinds of security and guarantees which assist bonds can be granted not only in favour of all bondholders, but also to a representative of the bondholders, which will be entitled to exercise in their name and on their behalf all rights relating to such security/guarantee, including enforcement.

Parallel debt arrangements are generally not recognised in Italy.

3.6 Loan Transfer Mechanisms

Perfection requirements change depending on whether the transfer is by transfer of contract (*cessione di contratto*) or by 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 obtained before assignment, by including an express consent in the relevant loan agreement or guarantee, as applicable.

On the contrary, the 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.

Assignment of receivables can be implemented under:

- Italian Civil Code provisions on the transfer of receivables;
- Article 58 of the Consolidated Banking Law, which allows the purchase of receivables portfolios by banks; and
- the Securitisation Law, which allows the purchase of receivables portfolios or single names by SPVs (see **1.5 Banking and Finance Techniques**).

In each case, receivables are transferred along with any relevant security or guarantee.

A transfer under the Italian Civil Code requires notification to the assigned debtors and the execution of certain formalities with respect to certain security (such as annotation of the transfer on the land registry for a mortgage).

Under the Consolidated Banking Law and the Securitisation Law, no notification to the assigned debtor is needed for the transfer of the relevant receivables and related security and guarantees to be effective.

3.7 Debt Buy-Back

Debt buy-back is not common in financing transactions.

As a general rule under Italian law, when the capacity as lender and borrower falls onto the same person, the underlying debt is extinguished together with ancillary rights (including security). Therefore, there is a risk of a court either:

- reclassifying the loan purchase as a prepayment, which may be in breach of prepayment provisions contained in the loan agreement; or
- subjecting the loan purchase to the pro rata sharing provisions in the loan agreement.

To overcome this, a buy-back may, eg, be structured as a purchase of the debt by the borrower's holding company.

3.8 Public Acquisition Finance

A tender offer of a listed company is usually financed by way of a loan.

The bidder may only make its notification to Consob (ie, the Italian authority in charge of financial markets) once it is in a position to fully fund the offer.

In particular, to ensure that the offer is fully funded and settled at closing, before the launch of the offer the bidder must give evidence to Con-

sob that it has funds readily available for the payment of the offer price for all the shares object of the offer.

To this end, before publication of the offer document, the bidder must either (i) deposit cash or readily disposable securities for an amount equal to the maximum value of the takeover (ie, the maximum amount that the bidder may be required to pay in case of full acceptance by the market of the takeover), or (ii) obtain a "cash confirmation" letter from a bank or other suitable financial institution that confirms availability of the funds for the same amount and which is irrevocable and unconditional.

3.9 Recent Legal and Commercial Developments

Legislative Decree No 14 of 12 January 2019 (the "New Bankruptcy Law") came into effect on 15 July 2022. The New Bankruptcy Law provided for a reorganisation of the bankruptcy legislation, even if the content of some important provisions (eg, claw-back) remained unchanged. For this reason, references to the Bankruptcy Law have been updated in the legal documentation by making reference to the New Bankruptcy Law.

Furthermore, a new kind of pledge entered into force in 2023: the non-possessory pledge (*pegno non possessorio*). Pursuant to Law Decree No 59 of 3 May 2016 (which was only implemented in 2023 following the enactment of certain implementing decrees by the Ministry of Economy and Finance and by the Revenue Agency), the entrepreneurs registered in the commercial register can create a non-possessory pledge to secure credits (owing by them or third parties), present or future, if determined or determinable and with the provision of the maximum guaranteed amount, relating to the exercise of their business.

3.10 Usury Laws

For the purpose of usury laws, both interest and other charges applicable in connection with a financing transaction shall be considered.

In broad terms, there are two different types of usury provided for by Italian law:

Objective usury, meaning applying interest exceeding the usury threshold independently of the nature or financial condition of the borrower.

Law No 108/1996 (the "Usury Law") sets out the relevant formula, providing that the threshold rate be calculated on the basis of the average annual percentage rate (TEGM) indicated in a decree to be published by the Ministry of Finance (MEF) on a quarterly basis.

In turn, the TEGM published by the MEF is based on a survey of the economic conditions applied in the market in the previous quarter that the Bank of Italy carries out each quarter.

Subjective usury applies when both of the following conditions are met.

- "Disproportion": the agreement provides for disproportionate interest amount with respect to principal and the average interest rates applied for transactions of the same type (even if the usury threshold is not exceeded).
- "State of difficulty": this does not mean a "state of need", but rather refers to both economic difficulty, based on a global evaluation of the borrower's assets, and financial difficulty, which is a temporary lack of liquidity.

Under Italian law, sanctions for usurious interest are twofold:

- civil sanctions: pursuant to Article 1815 of the Italian Civil Code, no interest shall be due and the borrower shall be entitled to claim the reimbursement of all interest amounts already paid to the lender; and
- criminal sanctions: pursuant to Article 644 of the Italian Criminal Code, criminal sanctions shall apply.

The concept of "supervening usury" refers to the case where interest is below the usury threshold at the start of the loan, but exceeds such thresholds at a later stage.

In this respect, the Italian Supreme Court has stated that compliance with the usury threshold is relevant only at the time of execution of the loan agreement, regardless of the time of payment.

3.11 Disclosure Requirements

The prospectus of a tender offer must state whether external financing is required, and if so, it must provide details of the identity of the creditors and the bidder's assumptions to pay the debt service (including whether the bidder is relying on the target company's financials). Similarly, any guarantees and security interests securing the bid must be disclosed and identified.

4. Tax

4.1 Withholding Tax

No withholding tax is chargeable on interest payable on loans made to resident lenders. A withholding tax (with rate of 26%) is chargeable on interest payable to a non-Italian resident lender (unless in case of lending through an Italian branch to which the loan is effectively connected).

The withholding tax can be reduced under the relevant provisions of the double tax treaty applicable between Italy and the country of residence of the beneficial owner of the interest.

In addition, no withholding tax applies to interest paid on medium- or long-term loans if extended, inter alia, by credit institutions established in EU and institutional investors subject to regulatory supervision established in countries that allow an adequate exchange of information with Italy.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Substantial registration taxes, depending on the nature of the security and the features of the facility agreement, may apply.

However, a substitute regime (the substitute tax) may be applicable in order to reduce the indirect taxes ordinarily applicable to the loan and the security package (eg, registration and mortgage taxes).

Substitute tax (generally at the rate of 0.25%) applies, upon the option of the parties, if the loan:

- is granted, inter alia, by Italian banks (including Italian permanent establishments of EU and non-EU banks), EU banks, Italian securitisation companies and EU collective investment funds;
- is entered into within the territory of Italy; and
- has a duration exceeding 18 months.

Where substitute 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 2%.

Registration taxes may not be payable if the security agreement is executed outside Italy (unless specific events, occur, eg, case of use, explicit reference or voluntary registration). However, certain securities must be registered in Italy for perfection purposes, eg, real estate mortgages, special privileges, pledges of quotas of limited liability companies (*società a responsabilità limitata*), pledges of intellectual property and mortgages on ships and aircraft.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Unlike EU banks and EU collective investment funds, foreign lenders may not benefit from substitute tax, which is a special regime which can be opted for in order to reduce the indirect taxes ordinarily applicable to the loan and the security package.

In addition, in order for substitute tax to be applicable, the loan must be entered into in Italy.

5. Guarantees and Security

5.1 Assets and Forms of Security

Under Italian law, security can be taken mainly over:

- shares or quotas of a company;
- real estate property;
- equipment and machinery;
- IP;
- receivables arising from contracts;
- bank accounts; and
- moveable assets.

The methods of taking security over the above assets vary according to the type of asset concerned.

Shares or Quotas

To grant a pledge over shares in a joint stock company or quotas in a limited liability company, a deed of pledge is required. To perfect a pledge over shares, a director of the company whose shares are pledged must annotate the pledge on the share certificates and in the company's shareholders' ledger. The security may be perfected on the same day of execution of the pledge agreement.

To perfect a pledge over quotas, the relevant deed must be notarised and filed with the competent companies' register (*registro delle imprese*); in addition, to the extent the constitutional documents of the company provide that the company maintains a shareholders' ledger, the creation of the pledge shall be annotated by a director of the company in its shareholders' ledger.

If the deed was executed before a foreign notary public, it must also be apostilled (where necessary) and deposited with an Italian notary public together with a sworn translation (if it is not drafted in Italian). The security is usually perfected within a week of filing the pledge agreement.

Inventory

In principle, a pledge over equipment and machinery (and raw materials) can be granted. However, in order for a pledge to be created, the pledged assets must be delivered to the lenders or to a third party designated as custodian by both the lenders and the grantor. The security may be perfected on the same day of execution of the security agreement.

Bank Accounts

This type of security qualifies as security over receivables (namely, over the balance on the relevant bank accounts). In the case of security over the balance on bank accounts, the depositary bank must make an annotation in its books. The security may be perfected on the same day of execution of the security agreement.

Receivables

Receivables that can form the subject of a security interest include:

- rental income;
- insurance proceeds; and
- receivables arising from share/asset purchase agreements.

Security over receivables can be granted in the form of an assignment by way of security or of a pledge. The perfection of the pledge requires the notification of the pledge to, or its acceptance by, the relevant debtor (with a document bearing a date certain at law). The debtor's notification or acceptance is also necessary to perfect assignment by way of security. With regard to insurance receivables, a loss payee clause (*clausola di vincolo*) can be included in the insurance policy.

The security may be perfected on the same day of execution of the security agreement.

Intellectual Property Rights

Security over Italian patents, designs, trade mark registrations and trade mark applications typically take the form of a pledge. A deed of pledge is required for this purpose. The perfection of the pledge requires the filing of the deed of pledge with the institutions where the intellectual property rights are registered (such as the Italian Patents and Trademarks Office and the European Union Intellectual Property Office). The deed of pledge must be notarised and is usually executed in Italian before an Italian notary public. It is in principle possible to execute it before a foreign notary public but, in this case, the deed must also be apostilled (where necessary) and deposited with an Italian notary public together with a sworn translation (if it is not drafted in Italian). The security usually takes a few weeks to be perfected and the timescale depends on the relevant offices.

Real Estate Assets

A deed of mortgage is required to grant a mortgage over land/property. The deed of mortgage must be notarised and registered in Italy. Therefore, it is usually executed in Italian before an Italian notary public. The perfection of the mortgage requires registration with the competent land register (to be carried out by the Italian notary public). The security usually takes a few weeks to be perfected and timescale depends on the relevant offices.

Movable Assets

Common forms of security over movable property include:

- pledges;
- special mortgages on registered movable property, such as aircraft and vessels; and
- floating charges under Article 46 of the Consolidated Banking Law (see **5.2 Floating Charges and/or Similar Security Interests**).

The security usually takes a few weeks to be perfected and timescale depends on the relevant courts.

5.2 Floating Charges and/or Similar Security Interests

While Italian law does not permit floating charges, there are two types of security under Italian law which have some of those characteristics.

Special Privilege

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:

- (i) existing and future equipment, concessions and produced goods of the enterprise;
- (ii) raw materials, semi-manufactured goods, stock, finished goods, fruit, livestock and goods;
- (iii) goods purchased with the loan in respect of which the special privilege is intended to be granted; and
- (iv) present or future receivables arising from the sale of the assets and goods listed in (i) to (iii).

Non-possessory Pledge Over Movable Assets

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; or
- 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 ten 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 arising from the sale or the substitute asset purchased with that consideration, as applicable, without giving rise to the creation of new security; this is, of course, very important to avoid claw-back risk.

5.3 Downstream, Upstream and Cross-Stream Guarantees

Under Italian law, the entry into a transaction (including the granting of a guarantee or security interest) by an Italian company is subject to, inter alia, compliance with the rules on corporate benefits, corporate authorisation and certain other Italian mandatory provisions.

An Italian company may only take those actions which fall within the corporate purpose of the company as stated in the company's articles of association. Furthermore, according to Italian law and principles, an Italian company, in order to be allowed to issue a guarantee, must have an actual corporate interest/benefit in the transaction. This benefit may be direct or indirect but it must be valuable and measurable using objective and rigorous criteria. The concept of a "corporate benefit" is not specifically defined in the applicable legislation and is determined by a factual analysis on a case-by-case basis. As a general rule, corporate benefit is to be assessed at the level of the relevant company on a stand-alone basis, although upon certain circumstances and subject to specific rules the interest of the group to which such company belongs may also be taken into consideration.

While corporate benefit for a downstream guarantee/security interest (ie, a guarantee/security

interest granted to secure financial obligations of direct or indirect subsidiaries of the relevant grantor) can usually be easily proved, the validity and effectiveness of an upstream or cross-stream guarantee/security interest (ie, guarantee/security interest granted to secure financial obligations of the direct or indirect parent or sister companies of the relevant grantor) depend on the existence of an actual and adequate benefit in exchange for the granted guarantee/security interest. In particular, the amount secured must be, in any event, reasonable taking into account the financial conditions and the turnover of the company granting the security.

As a general rule, the absence of an actual and adequate benefit could render the transaction (including granting a security interest or a guarantee entered into) by an Italian company ultra vires and potentially be affected by a conflict of interest. Any security interest or guarantee granted by an Italian company, without a proper corporate interest, could be declared null and void if the lack of corporate benefit was known or presumed to be known by the third party and such third party acted intentionally against the interest of the Italian company.

Civil liabilities may be imposed on the directors of an Italian grantor should a court hold that they did not act in the best interest of the grantor and that the acts carried out do not fall within the corporate purpose of the company or were against mandatory provisions of Italian law. The lack of corporate benefit could also result in the imposition of civil liabilities on those companies or persons ultimately exercising control over an Italian grantor or having knowingly received an advantage or profit from such improper control.

Lastly, under Italian law, a maximum guaranteed cap should be agreed.

Upon certain conditions, the granting of guarantees may be considered as a restricted financial activity within the meaning of Article 106 of the Italian Banking Act, whose exercise is exclusively reserved to banks and authorised financial intermediaries. Non-compliance with the provisions of the Italian Banking Act may, among others, entail the relevant guarantees being considered null and void. In this respect, Italian Decree No 53 of 2 April 2015 issued by the Italian Ministry of Economy and Finance, implementing Article 106, paragraph 3, of the Italian Banking Act, states that the issuance of guarantees or security by a company for the obligations of another company which is part of the same group does not qualify as a restricted financial activity, whereby "group" includes controlling and controlled companies within the meaning of Article 2359 of the Italian Civil Code as well as companies which are under the control of the same entity. As a result of the above-described rules, subject to the guarantor and the guaranteed entity being part of the same group of companies, the granting of the guarantees would not amount to a restricted financial activity.

5.4 Restrictions on the Target

A security agreement and the related documents are null and void if they violate financial assistance rules (that is, when a company grants a loan or a security related to a loan to another party to purchase the company's shares). However, the Italian Civil Code provides for the following exceptions, which allow financial assistance in certain circumstances.

Merger Leveraged Buyouts

Merger leveraged buyouts, where a company guarantees a loan granted to another company to purchase its shares on a merger between the two companies, are allowed under a specific procedure provided for in the Italian Civil Code.

Whitewashing

Financial assistance is allowed, in the case of a joint stock company (*società per azioni*), under a set procedure that requires:

- an extraordinary resolution of the general meeting;
- specific reports and statements by the directors; and
- compliance with a maximum threshold equal to the aggregate amount of the distributable profits and reserves of the target company.

Employees

Subject to certain conditions, the prohibition of financial assistance does not apply to loans or guarantees granted to employees of the company to promote the acquisition of its shares.

5.5 Other Restrictions

In addition to the legal restrictions and limitations described in **5.4 Restrictions on the Target**, there may be other restrictions set out in the constitutional documents of the company or in its contractual commitments, which might prevent the company from granting guarantees or security for its and/or other borrowers' financing or that might impose additional formalities on the relevant company.

5.6 Release of Typical Forms of Security

Typically, a deed of release is entered into between the secured creditor and the debtor to confirm the release of a security over the debtor's assets. Alternatively, a unilateral release may be executed by the secured creditor.

In addition, certain formalities may be required. By way of example, in the case of mortgages (whether over real-estate assets or vessels), the release should be filed with the competent registry (for which purpose the parties will need to execute a notarial deed of release).

5.7 Rules Governing the Priority of Competing Security Interests

Italian law provides a timing preference (*prior in tempore, potior in iure*), based on the date of creation (and with respect to a registrable security, the registration) of the security.

Priority rules may be varied contractually with the consent of all secured creditors, however, any contractual subordination provision is effective between the parties to the relevant agreement but is not enforceable in an insolvency scenario and the in-court restructuring proceedings.

In the case of mortgagees, ranking exchange between mortgagees shall be transcribed with the real estate register in order to be enforceable.

Legal preference and/or subordination exist in an insolvency situation (see **7.2 Waterfall of Payments**).

5.8 Priming Liens

Under Italian law, claims that, by operation of law, can prime a lender's security interest, are the ones of certain preferential creditors, including the claims of the Italian tax authorities and social security administrators, and claims for employee wages.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Mortgage

To enforce a real estate mortgage, the secured creditor must start a judicial procedure aimed at

selling the relevant real estate through an auction. If the value of the real estate asset is equal to or lower than the amount of the claim, the creditor may require the asset to be assigned to it.

Pledge

The enforcement of a pledge does not require a judicial procedure.

If the debtor does not fulfil its payment obligations within five days of a request by the secured creditor, the creditor can immediately ask the court bailiff to sell the relevant asset through an auction, or without an auction if the asset has a market price. The secured creditor can also ask the judge to assign the relevant asset to it as a fulfilment of the debtor's obligations.

A pledge over bank accounts is enforced through a notification to the depositary bank stating that the pledgor no longer has the right to benefit from the amounts credited on the relevant bank account and a request to retain an amount necessary to fulfil the debtor's obligations.

A pledge over receivables is enforced through a notification to the assigned debtors to pay the due amounts to the secured party.

Needless to say, enforcement of security (pledges or mortgages) forces the lender to notify the debtor of the enforcement and consequently exposes the lender to the possible opposition in court by the debtor that may delay enforcement for some time.

Exempt from such prior notice obligation is the enforcement of a financial collateral (*garanzie finanziarie*), which is, however, only available to banks and intermediaries subject to supervision and in relation to cash or financial instruments which have a market value.

A further very efficient security is the assignment of receivables by way of security because under such agreement the receivables become property of the lender as soon as they originate, and practically the lender "appropriates" the collateral from the outset and must only return any excess proceeds from the collection of the assigned receivables.

Another simplified enforcement procedure was introduced in 2016 for loans granted by banks and other authorised financial intermediaries registered under Article 106 of the Consolidated Banking Law that are secured by transfer of a real estate asset (*patto marciano*). The transfer is then only conditional on:

- payment default by the borrower; or
- notification of the transfer to:
  (a) the owner of the real estate asset; and
  (b) any other creditors with rights over the same real estate asset.

6.2 Foreign Law and Jurisdiction

Choice of Law

The choice of a foreign law as the governing law of a contract is valid under Italian law, pursuant to 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), which applies to contractual obligations in civil and commercial matters irrespective of whether the law in question is that of a member state.

However, the choice will not restrict the application of the "overriding mandatory provisions" (as defined in Rome I).

Choice of Jurisdiction
An Italian court will generally decline jurisdiction if the parties have submitted to the jurisdiction of a foreign court.

Immunity
Italian companies are generally not subject to sovereign immunity.

In principle, a waiver of sovereign immunity is allowed under Italian law. However, the possibility for governmental or other public agencies to waive their sovereign immunity shall be verified on a case-by-case basis.

The transfer of certain assets (eg, public concessions) may require a prior administrative authorisation in the context of the enforcement of a security.

6.3 Foreign Court Judgments
Judgments Given by EU Countries
Article 36 of EU Regulation No 1215/2012 provides that a judgment issued by the court of a member state shall be recognised in the other member states "without any special procedure being required".

Judgments Given by Non-EU Countries
The acknowledgment and enforcement of decisions issued by courts belonging to jurisdictions outside of the EU is generally governed by Law No 218/1995. The enforcement of a foreign decision in the Italian territory requires the filing of a petition before the Court of Appeal of the place where the enforcement shall then take place. Such proceedings usually last six months to one year, and the order authorising the enforcement of the foreign decision in Italy fully entitles the creditor to seek enforcement over the debtor's assets.

Arbitral Award
Italy is party to the 1958 New York Convention, which sets 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.

6.4 A Foreign Lender's Ability to Enforce Its Rights
As discussed at **3.5 Agent and Trust Concepts**, there are doubts as to the effectiveness or validity of a security interest expressed to be created under Italian law in favour of an entity acting as trustee or collateral agent for the creditors to be secured and holding the security interest in such capacity.

Any document that is not in Italian must be accompanied by an official sworn translation for it to be admissible by an Italian court or authority.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes
The judicial liquidation proceeding (*liquidazione giudiziale*) triggers a standstill on enforcement actions for the entire duration of the proceedings, with some exceptions, such as:

- enforcement actions on mortgaged assets according to mortgage credit rules (*credito*

fondiario) as set out in the Consolidated Banking Law;
- in very limited cases and under certain circumstances, creditors secured by a lien (*pegno*) or a privilege (*privilegio*); and
- enforcement of financial collateral arrangements pursuant to Legislative Decree No 170 of 21 May 2004 (implementation of Directive 2002/47/EC on financial guarantee contracts).

The restructuring proceedings (other than the certified recovery plan, on which see below) enable the debtor to file for an in-court standstill preventing enforcement actions that must be approved by the court on a case-by-case basis.

Some restructuring proceedings prevent lenders from accelerating their loans as a consequence of the simple opening of the proceedings (eg, composition with creditors).

7.2 Waterfall of Payments

In an insolvency procedure, claims are paid in the following order.

Pre-deductible Claims

These are statutory claims (such as tax or other government claims, or claims for professional services) and claims that arise during or for the purpose of the insolvency procedure. Creditors with pre-deductible claims are paid entirely (or pro rata, if the assets of the insolvent company are not sufficient to pay them all).

Preferential Claims

These include:

- claims with a general or special legal privilege (such as tax claims) over all or some of the assets of the insolvent company;
- creditors with a special privilege over a real estate asset rank before creditors with a mortgage over the same asset, while a special privilege over a movable asset ranks after a claim secured by a pledge over the same asset;
- the order of priority of privileged claims is set by law; and
- secured claims.

If privileged or secured creditors are not fully satisfied through the proceeds of sale of the assets, the unpaid portions rank as unsecured claims.

Unsecured Creditors

If a security interest has not been validly perfected, the creditor will rank as an unsecured creditor.

7.3 Length of Insolvency Process and Recoveries

The duration of insolvency processes varies depending on the different factors of each case.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

In 2022, the New Bankruptcy Law came into force. This New Bankruptcy Law was enacted with the aim of creating an organic system for the management of any crisis and insolvencies replacing the fragmented system based on the previous bankruptcy law (Royal Decree 267/1942).

The following is a brief overview of the rescue or reorganisation procedures other than insolvency (*liquidazione giudiziale*) available under the New Bankruptcy Law.

The New Bankruptcy Law makes available to a company several proceedings to restructure its indebtedness and overcome the crisis or insolvency, among which the most relevant are:

- negotiated corporate crisis resolution proceedings (*composizione negoziata della crisi d'impresa*);
- the certified recovery plan (*piano attestato di risanamento*);
- the debt restructuring agreements (*accordo di ristrutturazione dei debiti*);
- simplified composition for the liquidation of assets (*concordato semplificato per la liquidazione del patrimonio*); and
- settlement with creditors (*concordato preventivo*).

The proceedings range from consensual instruments to arrangements based on creditors majority-vote and may be conducted out of court (*piano attestato di risanamento*), or in full or in part in court.

Under these proceedings:

- the debtor may apply for an in-court standstill preventing creditors from taking enforcement actions (other than in case of *piano attestato di risanamento*); and
- payments made and guarantees granted by the debtor during the proceedings and/or in execution of the relevant restructuring plan are exempt from claw-back and certain insolvency-related crimes.

It is actually the exemption from claw-back that makes such instruments very attractive for lenders when a debtor is in financial difficulty.

7.5 Risk Areas for Lenders

In addition to the consequences described at **7.1 Impact of Insolvency Processes** with respect to the suspension of enforcement proceedings, lenders should be aware of the following.

Claw-Back

Some acts, transactions and security interests may be subject to claw-back actions (*revocatoria*) by the receivership 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.

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.

Corporate Benefit

Any loan taken, security or guarantee granted by a company must be justified by a specific corporate benefit for the company or its group. In the absence of a corporate benefit, the relevant contracts may be declared null and void.

8. Project Finance

8.1 Recent Project Finance Activity

Project finance is a very active market in Italy, notably in the renewables sector, in line with the global trend of fostering energy transition.

Due to the current reduced state support for the feed-in tariff scheme, an emerging trend is the development, and relevant demand, for the financing of renewable energy plants on the

basis of pure merchant risk, along with the possibility of providing long-term power purchase agreements.

8.2 Public-Private Partnership Transactions

In the past 20 years, there have been many Public Private Partnership (PPP) transactions, in particular in transportation (motorways) and hospitals.

PPP transactions are particularly relevant given that the measures of the so-called PNRR (National Recovery and Resilience Plan) are fully operational and a strong commitment from the public administration is required for the project capability.

Following the enactment of new Public Contracts Code (Legislative Decree 31 March 2023, No 36), some changes have also been introduced in relation to the regulation of PPPs.

Although the previous Public Contracts Code had the merit of introducing the organic discipline of the PPP, a process began to innovate this legal arrangement, making it more relevant within the new Public Contracts Code.

The Code was the output of the works of a special Committee of mixed composition (Councillors of State, lawyers, technicians, university professors) for the purpose of simplifying and accelerating procedures, in order to streamline procedures and ensure full compliance with European principles.

8.3 Governing Law

Generally, project agreements are governed by Italian law, but it is possible for the parties (i) to apply a foreign law by express choice made under the relevant contract and (ii) to opt for international arbitration to settle disputes.

In any case, the "overriding" mandatory provisions of Italian law may not be derogated from, upon penalty of disapplication by the Italian courts.

Project agreements entered into with Italian public entities shall, on the contrary, be governed by Italian law and disputes shall be submitted to Italian courts.

8.4 Foreign Ownership

Article 16 of the general law provisions of the Italian Civil Code states that a foreigner is allowed to enjoy the civil rights granted to citizens subject to reciprocity and subject to provisions contained in particular laws. This provision also applies to foreign legal persons.

As a consequence, foreign entities may own or otherwise have real property Italy only if their country of origin offers the same opportunity to Italian entities.

However, it is to be noted that the following individuals are, inter alia, treated on par with Italian citizens and are therefore exempted from the verification of reciprocity:

- citizens (natural or legal persons) of EU member states, as well as citizens of EEA countries (Iceland, Liechtenstein and Norway); and
- citizens (natural or legal persons) of those countries with which Italy has concluded bilateral agreements on the promotion and protection of investments (bilateral investment treaties).

8.5 Structuring Deals

Issues to be considered when structuring a project financing deal include, inter alia, the following.

Legal Form of the Project Company

SPVs are normally incorporated in the form of a joint stock company (*società per azioni*) or limited liability company (*società a responsabilità limitata*).

In PPP contracts, the concession agreement is often executed between the grantor and a temporary association of companies (*associazione temporanea di imprese*) (ATI) following a tender procedure. Under the Public Contracts Code, the ATI which has been awarded the concession must incorporate the project company (the SPV), which will the replace the ATI in the concession agreement.

Restrictions on Foreign Investment

The foreign direct investments regime in Italy, the so-called Golden Power regime, allows the Italian government to scrutinise transactions that concern "strategic" industrial sectors, and grants it the power to apply conditions to such transactions or even veto them in the case of threat to the national economy or security. The regime was introduced in 2012 and has been reinforced and expanded.

This applies also to the energy sector.

Cons for borrowers

Cons for borrowers include:

- complex financial documentation, which involves many parties and long negotiations;
- strict subordination undertakings, distribution blocks and cash sweep covenants; and
- covenants and reserved discretions granted to the lenders under the financial documentation.

8.6 Common Financing Sources and Typical Structures

In the vast majority of cases, project financing in Italy is implemented by means of a non-recourse/limited recourse banking loan facility.

More recently, the capital markets have become an alternative to standard project financing, through project bonds or so-called mini-bonds. However, such instruments are not used as frequently as loans, due to the flexibility that a limited syndicate of creditors gives to the sponsor when having to amend or waive a specific term of the financing.

Usually, the main parties involved in a project financing are the following.

- The SPV that owns the main assets relating to the project (authorisations, permits, real estate rights, etc). The SPV acts as borrower under the facility agreement.
- The lenders.
- The sponsors/shareholder(s) of the SPV, which are usually required to make equity contributions. The shareholder(s) usually grant a first ranking pledge over the shares/quotas representing the entire corporate capital of the borrower.
- The counterparties of the borrower under the project contracts (engineering, procurement and construction (EPC), and operation and maintenance (O&M) contractors).

8.7 Natural Resources

The Italian state has title to minerals and other natural resources under Article 822 and following sections of the Italian Civil Code.

The state can grant a licence/concession to private operators for the exploitation of natural resources such as mines and gas fields. Foreign companies can acquire rights to the concession for the exploitation of the state-owned asset. There are some exceptions under special laws and these matters should be subject to specific due diligence on a case-by-case basis.

8.8 Environmental, Health and Safety Laws

Environmental regulations are largely issued by regional authorities and will therefore be case-specific, based on the location of the project.

JAPAN

Law and Practice

Contributed by:
Hiroki Aoyama and Yuki Matsuda
Mori Hamada & Matsumoto

Contents

Mori Hamada & Matsumoto is a full-service law firm that has served clients since its inception in 2002. The firm's 100-strong banking practice group supports clients in Japanese and cross-border transactions by providing a full range of legal services, from structuring transactions to negotiating documentation in areas including corporate loans, structured finance, real estate finance, acquisition finance, mezzanine finance, intellectual property finance and derivatives. Mori Hamada & Matsumoto advises financial institutions and investors, including some of the world's largest commercial and investment banks and multinational corporations. The team's key areas of expertise include LBO finance, real properties-backed financing, energy, infrastructure and project finance, and banking and financing regulation.

Authors

Hiroki Aoyama is a partner at Mori Hamada & Matsumoto, specialising in banking, LBO finance, structured finance, real estate investment, project finance, derivatives and capital markets. He received his LLB from the University of Tokyo in 2001, and his LLM from Harvard Law School in 2007. He worked at Debevoise & Plimpton, New York, from 2007 to 2008. He is admitted to practise in Japan and the state of New York. Between 2011 and 2013, Hiroki was a lecturer at the University of Tokyo, Faculty of Law (Civil Law).

Yuki Matsuda is a banking and finance partner of Mori Hamada & Matsumoto, where he mainly focuses on banking, LBO finance and asset finance. He has extensive experience in financial practice, including arranging major domestic and overseas finance projects at a securities firm. He received his LLB from the University of Tokyo in 2010, and his LLM from the University of Virginia School of Law in 2018. He worked at Morgan Lewis & Bockius LLP, New York, from 2018 to 2019. He is admitted to practice in Japan and the State of New York.

Mori Hamada & Matsumoto

16th Floor
Marunouchi Park Building
2-6-1 Marunouchi
Chiyoda-ku
Tokyo 100-8222
Japan

Tel: +81 3 6212 8330
Fax: +81 3 6212 8230
Email: mhm_info@mhm-global.com
Web: www.mhmjapan.com

MORI HAMADA & MATSUMOTO

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Under the current administration, an accommodating monetary policy has bolstered financial institutions' lending appetite. Competitive market dynamics have also put downward pressure on interest rates and lending fees.

Borrowers are therefore benefiting from easy access to debt financing. Japanese companies have been increasing capital expenditure for several years. M&A, infrastructure projects and the real estate market have also been active. The value of outstanding loans held by Japanese banks exceeded JPY561 trillion at the end of 2022, compared to JPY537 trillion at the end of 2021.

1.2 Impact of the Ukraine War

The impact of the Ukraine War on the Japanese loan market has been limited thus far.

The amount of outstanding loans to Russia and Ukraine held by Japanese financial institutions is quite limited. However, loans to Russian borrowers with a long maturity may be substantially affected by a decline in the borrower's cash flow due to economic sanctions or suspension of trading with its international business partners.

Generally, given the substantial uncertainty of the situation in Ukraine, Japanese banks are paying attention to the potential negative impact on the global economy caused by sanctions and rising resource and energy prices.

1.3 The High-Yield Market

Given the relatively wide availability of senior facilities provided by banks, the role played by high-yield facilities has been somewhat limited. However, high-yield and mezzanine debt remain popular for borrowers seeking to stretch debt capacity in structured transactions such as leveraged buyouts and real estate acquisitions. Mezzanine debt is typically provided in the form of subordinated loans or preferred shares.

1.4 Alternative Credit Providers

Banks and other conventional financial institutions continue to play a central role in the Japanese loan market, with the most sizeable being the three "mega banks" (Mizuho, MUFG and SMBC), which, together with Resona and Resona Saitama, accounted for 39.0% of the outstanding loan balance as of the end of 2022. Other players include non-bank money lenders, private investment funds and government-related financial institutions.

1.5 Banking and Finance Techniques

Mezzanine financing, typically in the form of subordinated loans or preferred shares, is sometimes used by borrowers seeking to stretch debt capacity in structured transactions such as leveraged buyouts and real estate acquisitions. See **1.3 The High-Yield Market**.

Mezzanine financing can be structured by means of a contractual subordination structure, as described in **5.7 Rules Governing the Priority of Competing Security Interests**. Therefore, HoldCo structures (ie, structural subordination which involves borrowing entities at different levels, where the subsidiary borrows senior debt and the parent borrows subordinated debt) are not required to accomplish subordination of a loan. However, recently, in the loan market in Japan, some sponsors seek to benefit from higher leverage at the sponsor level by taking out HoldCo loans; particularly in leveraged buyouts. Because the use of HoldCo structures in Japan is relatively new, parties are relatively flex-

ible in negotiations on the terms and structures, as compared to more traditional types of transactions.

1.6 ESG/Sustainability-Linked Lending

The Ministry of the Environment of Japan (MOE) developed the "Green Loan and Sustainability-Linked Loan Guidelines 2020" (as amended, the "MOE Guidelines") in March 2020, which were prepared based on the globally accepted principles published by international loan market associations. The MOE Guidelines provide the basic framework for engaging in green loans and sustainability-linked loans in practice. Through the continuous updating of the guidelines to reflect precedents and dialogue with market participants, the foundation for the promotion and growth of green loans and sustainability-linked loans is developing in Japan.

While there are still some areas that require further discussion and improvement (including the establishment of the setting and evaluation methods of the sustainability performance targets (SPTs), expansion and implementation of information disclosure standards and systems, as well as tackling "green wash" or "sustainability wash"), it is expected that ESG and sustainability lending will make significant progress, backed by the large-scale financial resources available in the indirect finance market in Japan.

2. Authorisation

2.1 Providing Financing to a Company

A lender who makes a loan in Japan must have a licence under Japanese regulation if that loan is made as part of its money-lending business, subject to certain exemptions (such as intra-group lending). The licence requirement will be satisfied if the lender is licensed as a bank or a Japanese branch of a foreign bank, or if it is registered as a money lender.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Provided that foreign lenders abide by the licence requirement described in **2.1 Providing Financing to a Company**, there are no further material restrictions applicable only to foreign lenders. If a foreign lender cannot abide by the licence requirement, it may consider subscribing bonds rather than making loans.

3.2 Restrictions on Foreign Lenders Receiving Security

There are no material restrictions on receiving security or guarantees that apply only to foreign lenders. For further information on the enforcement of security interests by foreign lenders, see **6.4 A Foreign Lender's Ability to Enforce Its Rights**.

3.3 Restrictions and Controls on Foreign Currency Exchange

The Foreign Exchange and Foreign Trade Act sets out the Japanese policy regarding foreign currency exchange. As far as normal international lending is concerned, there are certain post facto reporting requirements.

3.4 Restrictions on the Borrower's Use of Proceeds

There are no general regulations that restrict the use of loan proceeds. However, financial institutions are regulated under the Criminal Proceeds Transfer Prevention Act, which aims to prevent money laundering and financial support for terrorism activities. To that end, the Act requires financial institutions to:

- undertake know-your-customer procedures before entering into a loan transaction with a borrower;
- create and maintain transaction records; and
- report to the relevant authority if they find suspicious transactions.

Under the recent amendment of the Act, if the borrower is a corporation, financial institutions are required to identify the individuals who have substantial control over that borrower.

If the loan proceeds are used for money laundering, terrorism or other anti-social activities, it may expose lenders to reputational risks at the very least. To mitigate this risk, the use of the proceeds of a bank loan is usually specified in the loan agreement, and misuse thereof would be an event of default. Under standard syndicated loan documentation, the unanimous vote of the lenders is required in order for the borrower to change the use of the proceeds.

3.5 Agent and Trust Concepts

In general terms, Japanese law recognises the concepts of agent and trust. In practice, administrative agents and security agents are commonly appointed in syndicated loan transactions governed by Japanese law. However, the agents' roles are limited to administrative functions in most cases, and parallel debt structures (whereby the parallel debts belong to the agent who holds security interests on behalf of the lenders) are rarely adopted, although such structures are not impossible under Japanese law.

The use of security trust structures – whereby the security trustee holds security interests on behalf of the lenders – is also limited, although they are explicitly permitted under Japanese law. In many cases, each of the syndicated lenders holds its security interest on its own behalf and an inter-creditor agreement sets out the restrictions on its exercise, such as the enforcement being prohibited in the absence of majority lenders' consent.

3.6 Loan Transfer Mechanisms

The most common transfer mechanism in the secondary loan market is the outright transfer of loan receivables. A loan receivable can be transferred without the borrower's consent, unless the relevant loan document provides otherwise. The benefit of the associated security package can be transferred, with or without the consent of the security provider and other lenders, depending on the nature of the security interests, such as whether the security interest is a fixed security or a blanket security. Many loan documents oblige the security providers to co-operate with the secondary transaction by giving consent to the transfer of the security interest, subject to certain conditions.

Another secondary mechanism is loan participation. Under a participation arrangement, the loan receivable and security package does not legally transfer to the participant. As such, the participant benefits indirectly from the security package via the lender's enforcement.

3.7 Debt Buy-Back

Japanese law does not prohibit a borrower or sponsor from agreeing with the lenders to buy back its debt. If the borrower buys back its own debt, the debt automatically disappears, unless it is provided as collateral in favour of a third party. If a sponsor buys back the debt, the debt obligation remains outstanding, which creates an issue regarding how to treat the sponsor's share of the debt in the context of syndicate voting. Some syndicate loan agreements address this situation, but many others do not.

3.8 Public Acquisition Finance

Under the Japanese tender offer bid (TOB) regulation, the offeror must be able to demonstrate its ability to fund its tender offer at the launch date. The offeror may satisfy this requirement by submitting a commitment letter provided by a financial institution. The Japanese Financial Services Agency (the FSA) has stated that the commitment letter provided for this purpose must evidence the certainty of funding to a fairly reliable degree. However, no further details of this requirement have been officially announced. In practice, the relevant financial bureau may provide comments on the draft commitment letter before the launch date of the tender offer.

Borrowers generally negotiate with the lenders over the conditions precedent to eliminate the uncertainty of funding as much as possible. Lenders and borrowers sometimes agree on so-called "certain funds" terms, although the details may differ on a case-by-case basis. One of the most typical categories of transaction where these types of terms are negotiated is the leveraged public acquisition deal, although such negotiations also occur in the course of private acquisition finance transactions.

Under the Japanese TOB regulation, the offeror is required to disclose documentary evidence of its financial ability to fund the tender offer through the online disclosure system of the FSA, the Electronic Disclosure for Investors' NETwork (EDINET). Therefore, commitment letters in precedent cases are publicly available on EDINET.

3.9 Recent Legal and Commercial Developments

A working group established by the Legislative Council of the Ministry of Justice of Japan released an interim draft on the proposed legal reform for a new framework for security interests over movable properties and receivables. The interim draft aims to codify conventional practices for taking security interests, as well as to facilitate the taking of security over a pool of properties (by, among other things, improving the registration system).

In addition, the interim draft includes a proposal for the introduction of new legal system for blanket collateral (*jigyo tampo ken*), which may promote lending practices that do not rely on real estate collateral or individual guarantees provided by management members. In February 2023, another study group organised by the FSA also released a report on the introduction of a similar legal framework for blanket collateral with a view to facilitating funding for start-ups and revitalised companies. At the time of writing, it is difficult to predict whether these new proposals would be implemented in the near future.

3.10 Usury Laws

There are usury laws in Japan. Although multiple Acts address this issue in a complex manner, the most notable law is that the maximum interest rate for loan transactions is 15% where the amount loaned is JPY1 million or more.

The usury laws provide that fees or other monies paid to a lender in respect of a loan are deemed to be interest for the purpose of the interest-rate cap. In this context, the scope of "deemed interest" often becomes a practical issue. Firstly, under the Commitment Line Act, commitment fees are statutorily exempted from the scope of deemed interest, provided that the borrower falls within the prescribed categories, such as a stock corporation with share capital of more than JPY300 million. Secondly, whether other fees such as the arrangement and agent fees fall within the scope of deemed interest has, at times, been a critical issue. The practition-

ers' approach to this issue is that, put simply, if the independent and substantial services (such as arrangement services) are provided and the amount of fees are within a reasonable range for such services, the fees should not fall within the scope of deemed interest.

3.11 Disclosure Requirements

There are no general rules regulating disclosures of financial contracts. However, financial covenants associated with loans or bonds need to be disclosed in the borrower's or issuer's annual securities report if such disclosure is necessary to ensure that investors can make informed decisions based on the company's financial condition, operating results, and cash flow status.

In addition, a working group established by the FSA released a draft on the proposed legal reform for facilitating disclosure of financial covenants. Under the proposed framework, for example, if a company submitting an annual securities report borrows loans or issues corporate bonds with financial covenants, and the aggregate amount of the loans or bonds represents 3% or more of the consolidated net assets of the company, the company will be required to submit an extraordinary report describing the outline of the underlying contract and details of the financial covenants.

In the case of a tender offer bid, the offeror is required to disclose documentary evidence (typically, a commitment letter) of its financial ability to fund the tender offer, which will be publicly available on EDINET (see **3.8 Public Acquisition Finance**).

4. Tax

4.1 Withholding Tax

A cross-border payment of loan interest by a Japanese borrower to a foreign lender is subject to Japanese withholding tax, subject to certain exemptions. The tax rate is 20.42%, unless an applicable tax treaty provides otherwise.

4.2 Other Taxes, Duties, Charges or Tax Considerations

A written loan agreement is subject to stamp duty, the amount of which differs depending on the amount loaned and the nature of the loan transaction, such as whether the loan is a term loan or a line of credit. The maximum duty amount is JPY600,000 per loan document.

Corporate taxation differs depending on the status of each party. International lenders should note that their Japanese tax treatment changes depending on whether or not the profit relating to the loan arises through their permanent establishment in Japan.

Other taxes and charges that may become relevant to a loan transaction include registration fees and notary fees for the perfection of security interests, and court fees for the commencement of the judicial enforcement of security interests.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

As mentioned in **4.1 Withholding Tax**, a cross-border payment of interest on a loan by a Japanese borrower may be subject to Japanese withholding tax. To address the withholding tax issue, a cross-border loan agreement usually contains a tax gross-up clause. In addition, offshore lenders of a syndicated loan are often excluded from the qualified assignees of loans due to withholding tax considerations.

5. Guarantees and Security

5.1 Assets and Forms of Security

The typical forms of security interest and perfection requirements corresponding to each type of asset are set out below. If the security is not perfected, the lender cannot assert its preferred position vis-à-vis third parties. Such third parties include perfected secured creditors, perfected acquirers of the target's properties, and the bankruptcy trustee of the security-provider.

Real Estate

A mortgage is the most typical form of security for real estate. The secured obligation can be specified (ordinary mortgage; *futsu-teito*) or designated as a certain group of unspecified obligations (blanket mortgage; *ne-teito*).

Lenders register the mortgage at the relevant legal affairs bureau in order to perfect the mortgage. The registration fee is 0.4% of the amount of secured obligation. To reduce the upfront cost, some lenders permit the borrower to make a provisional registration only, which costs JPY1,000 per property. Once the mortgage is provisionally registered, the mortgagee reserves priority over other mortgagees who register their mortgages after the provisional registration. However, provisional registration is of little use unless formal registration is completed, so lenders need to ensure that they are always in possession of all documents necessary to allow them to register the mortgage formally.

Movable Properties

Pledges and security assignments (ie, security by way of assignment or assignment for the purpose of security) are the most typical forms of security for movable properties. The secured obligation can be specified or designated as a certain group of unspecified obligations.

To effectuate a pledge over movable properties, actual delivery of the subject properties is required. For this reason, security assignment is more often adopted, since actual delivery is not required.

To perfect a security assignment of movable properties, actual delivery or constructive delivery (such as the occupant's manifestation of its intent to occupy the subject assets on behalf of the lenders) of the target properties is required. Registration of the transfer will also perfect the security assignment.

Movable properties can be collateralised as individual properties or as a pool of properties. The pool needs to be sufficiently identified by specifying the type of asset, the location and other necessary criteria. This method enables the lenders to capture after-acquired movable properties as security.

Receivables

Pledges and security assignments are the most typical forms of security for receivables. The secured obligation can be specified or designated as a certain group of unspecified obligations.

Lenders can perfect the pledge or security assignment by giving notice to, or obtaining consent from, the obligor in written form, together with a notarised date certificate. Registration of the pledge or transfer will also perfect the pledge or security assignment.

Future receivables can be subject to the pledge or security assignment if the target receivables are sufficiently identified and follow the other requirements.

Receivables may be collateralised without having to obtain the obligor's consent even if the

underlying contract has a transfer restriction clause. However, if receivables are collateralised in breach of a contractual restriction, the obligor may refuse to pay the secured party upon the enforcement of the security if the secured party was aware, or due to gross negligence unaware, of the restriction at the time of collateralisation. One exception to the foregoing general rule relates to bank deposits, which cannot be collateralised without the bank's consent. Banks are generally reluctant to give consent unless they are a secured party.

Shares

A pledge is the most typical form of security for shares. The secured obligation can be specified or designated as a certain group of unspecified obligations.

Even if the articles of association of the issuer contain transfer restrictions, a share pledge can be effectuated by an agreement between the pledgor and the pledgee. However, lenders sometimes request that the target company amend its articles of association so as not to hinder the enforcement of the pledge, or otherwise to ensure the smooth enforcement of the share pledge.

The perfection method differs depending on the type of shares. If the shares are dematerialised, the pledge is perfected by means of electronic book-entry. If not, the share pledge is perfected by delivery of the share certificate representing the pledged shares. If the shares are not dematerialised and the issuing company does not issue share certificates pursuant to its articles of association, the share pledge is perfected by requesting that the issuing company record the pledge on its shareholder ledger.

Others

Other types of assets – such as debt securities, IP and trust beneficial interests – are taken as security and perfected in accordance with the steps applicable to each type of asset.

5.2 Floating Charges and/or Similar Security Interests

The concept of a universal security interest (whereby the lender is granted security interest over all the debtor's property, whether present or after-acquired, to secure its secured obligation) is not available to secure loan obligations under Japanese law. Therefore, lenders need to follow the creation and perfection procedure for each type of collateral asset. As mentioned in **5.1 Assets and Forms of Security**, future (after-acquired) movable property and receivables can be collateralised to the extent that doing so is permitted under the applicable requirements.

5.3 Downstream, Upstream and Cross-Stream Guarantees

There are no specific statutory limitations or restrictions on downstream, upstream and cross-stream guarantees. However, there are often issues in relation to upstream guarantees, due to the general fiduciary duty owed by the guarantor's directors. If a subsidiary provides an upstream guarantee solely for the benefit of a majority shareholder (owning less than 100% of the shares in the guarantor) in the absence of the subsidiary's corporate benefit, the directors of the subsidiary will be exposed to the risk of breaching their fiduciary duties. To avoid this risk, in practice, upstream guarantees are often made subject to the consent of any minority shareholders.

5.4 Restrictions on the Target

In general, a subsidiary is restricted from acquiring its parent's shares. This restriction is inter-

preted to be applicable not only where the subsidiary legally acquires its parent's shares, but also to a transaction that results in the economically equivalent result. Theoretically, it is not totally clear whether a target providing financial assistance for the acquisition of its own shares conflicts with such a restriction. However, it is common practice for the acquired target company to grant security or provide a guarantee to secure the acquisition facilities borrowed by the parent vehicle and partially funded by the sponsor.

If an acquisition vehicle does not acquire 100% of the shares in a target and the target grants security or provides a guarantee in respect of the acquisition, this may give rise to an issue regarding the target director's fiduciary duties. See **5.3 Downstream, Upstream and Cross-Stream Guarantees**.

5.5 Other Restrictions

In addition to the general rules explained above, there are some special statutory restrictions in relation to granting security or providing guarantees. For example, granting security over insurance claims arising under a liability insurance policy is prohibited. Also, an individual cannot guarantee unspecified obligations without specifying the maximum amount of the guarantee. Guarantee by an individual is restricted in some other respects.

5.6 Release of Typical Forms of Security

If the secured obligation of a security interest is specified, the security interest disappears upon full payment of the secured obligation by operation of law. If the secured obligations are designated as a certain group of unspecified obligations, the lenders usually need to release the security interest in order for that security interest to disappear.

5.7 Rules Governing the Priority of Competing Security Interests

The general rule is that the priority among several security interests over an asset is determined by reference to the time at which each security interest is perfected, or the first perfected security is given first priority. Therefore, as a matter of ranking the security interests, subordination can be created in many cases by perfecting the subordinated lender's security after the senior lender perfects its own security.

There are technical difficulties in creating several security interests with different rankings over some types of assets. For example, theoretically, it is not clear whether there can be several security assignments over one property. Moreover, the book-entry system does not accept multiple pledges over dematerialised shares. In these cases, senior lenders and subordinated lenders agree to contractual subordination or other arrangements to accomplish a similar outcome.

Unsecured Obligations

Among unsecured obligations, several methods of subordination are used. Aside from structural subordination (which involves borrowing entities at different levels, where the subsidiary borrows senior debt and the parent borrows subordinated debt), there are two types of contractual subordination structure: absolute subordination and relative subordination.

Absolute subordination arrangement

Under an absolute subordination arrangement, in an insolvency situation, the payment of subordinated debt is conditional on the full payment of the senior debt. Senior lenders thus ensure that the subordinated lender does not receive payment in priority to, or at the same ranking with, the senior lender.

Relative subordination arrangement

The essence of a relative subordination arrangement is an inter-creditor agreement between the senior and subordinated lenders. Typically, the subordinated lenders agree to hand over any payment they receive from the borrower to the senior lenders until the senior debt is paid in full, subject to certain exceptions. This type of arrangement is not intended to be effective vis-à-vis an insolvent borrower.

5.8 Priming Liens

A statutory lien (*sakidori-tokken*) and retention rights (*ryuchi-ken*) may be created over real estate, movable property or other assets by operation of law in certain situations. In project finance, for example, lenders usually request counterparties to the major project agreements to waive their retention rights (*ryuchi-ken*) or other statutory liens to ensure the lenders' smooth exercise of step-in rights.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

The central requirement for a lender to be able to enforce its security interest is that the secured obligation remains unpaid when due and payable. The lender typically declares an acceleration of the entire secured obligation pursuant to the loan agreement if it enforces its security interest before final maturity.

Under standard security documentation, a lender may choose to enforce a security interest created in a commercial transaction by a judicial (in-court) procedure or private (out-of-court) process.

Using judicial enforcement, a lender may enforce a mortgage over real estate by submitting the real estate registration certificate on which the mortgage is registered. Typically, that real estate is then sold to a third party through a judicial auction process, and the sale proceeds are applied to the repayment of the secured obligation.

One of the problems with judicial enforcement is that the sale proceeds are likely to be substantially lower than would be realised through a private auction. A lender should therefore consider selling the subject property out of court, or acquiring the subject property itself at fair value and discharging the secured obligation by the same amount.

6.2 Foreign Law and Jurisdiction

Japanese courts generally recognise the validity of the choice of a foreign law as the governing law of a contract, but the governing law of security interests cannot be chosen by the parties. For example, security interests over real estate and movable properties are governed by the law of the location of the subject properties.

Japanese courts also generally recognise the validity of a submission to a foreign jurisdiction.

A waiver of sovereign immunity is upheld, provided that it is made in compliance with the requirements of the Act on the Civil Jurisdiction of Japan with respect to a Foreign State.

6.3 Foreign Court Judgments

Japanese law adopts the principle of reciprocity regarding the recognition of foreign judgments. As such, Japanese courts will recognise final and conclusive civil judgments rendered by a foreign court, provided that:

- the foreign court is deemed to have valid jurisdiction over the matter, based on relevant laws or treaties;
- the unsuccessful party received due service of process or appeared in court;
- the content of the judgment and the related court proceedings are not contrary to the public order and good morals of Japan; and
- there is reciprocal recognition between the relevant foreign jurisdiction and Japan.

Japan is a party to the New York (1958) and Geneva (1927) Conventions, so the recognition of a foreign jurisdiction is determined in accordance with these conventions, to the extent they are applicable. Otherwise, the recognition of a foreign arbitral award is determined based on the same requirements as apply to a domestic arbitral award under the Arbitration Act, which are as follows:

- that the award must be final and conclusive;
- that the parties must have received due service of process and been afforded the opportunity to defend themselves;
- that the award must have been given in accordance with the law of the location of the arbitration; and
- that the contents of the arbitral award must not be contrary to the public order and good morals of Japan.

6.4 A Foreign Lender's Ability to Enforce Its Rights

Regarding the enforcement of share pledges, foreign lenders are restricted from acquiring pledged shares over companies that conduct certain limited categories of business related to national security, including telecommunications, broadcasting and aviation.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

There are three major statutory insolvency proceedings: bankruptcy (*hasan*), civil rehabilitation (*minji saisei*) and corporate reorganisation (*kaisha kousei*). Bankruptcy results in the liquidation of the borrower's business, while the other two proceedings allow the debtor's business to continue once substantial changes have been made to its assets, liabilities and equity, pursuant to a rehabilitation or reorganisation plan.

Statuary Insolvency Proceedings

Under statutory insolvency proceedings, creditors of unsecured claims are generally prohibited from enforcing their loans once judicial insolvency proceedings have commenced (and, in most cases, immediately after the insolvency application has been filed with the court) with respect to the borrower. Unsecured creditors must instead recover their claims in accordance with the insolvency procedure, in terms of both the timing and the amount of the recovery. The same applies to the enforcement of a guarantee in the insolvency of the guarantor.

The general rules applicable to secured creditors depend on which of the three insolvency proceedings is chosen.

Corporate Reorganisation Proceedings

Under corporate reorganisation proceedings, secured creditors are prohibited from enforcing their security interests outside the reorganisation proceedings, and can receive repayment only in accordance with the reorganisation plan approved in the reorganisation proceedings, in terms of both the timing and the amount of the recovery. More than two thirds of the voting rights held by all secured creditors need to be voted in favour of a reorganisation plan if the

plan provides for a rescheduling of the secured claims, and more than three quarters of the voting rights are needed if the plan provides for other restrictions on the security interests (for example, a haircut of the secured portion of the claims held by the secured creditors).

The Corporate Reorganisation Act recognises the concept of a "cram-down", whereby the court may approve a plan without the consent of certain classes of creditors; for example, the secured class of creditors (Article 200-1). However, in order for the court to approve a plan pursuant to a cram-down provision, the court is required to grant fair protection to the objecting class of creditors, for example by distributing the fair value of the security interest to the secured claim holders.

Bankruptcy and Civil Rehabilitation

Under bankruptcy proceedings and civil rehabilitation proceedings, the enforcement of a security interest is, in principle, not affected by the insolvency of the borrower. However, there are notable exceptions to this general rule with regard to civil rehabilitation. First, the court may issue an injunctive order to stop the enforcement of a security interest by a creditor, to the extent that the injunctive relief would be in the general interest of creditors and the relevant secured creditor would not suffer unjustifiable damage as a result. Second, the court may approve the extinguishment of security interests where the collateral is essential for the continuance of the debtor's business.

However, in order for the extinguishment to be utilised, the debtor is required to pay off the fair value of the collateral to the security-holder. The fair value will be determined by the court, and the secured creditor may request an expert appraisal if it is not satisfied with the value proposed by the court.

7.2 Waterfall of Payments

Unsecured loans, including any unsecured portions of partially secured loans, are usually treated as general claims in Japanese insolvency proceedings.

General claims are subordinated to common benefit claims, such as fees to the bankruptcy trustee, and preferred general claims, such as wages for employees and certain tax claims.

However, general claims have priority over certain subordinated claims, such as accrued interest arising after the commencement of insolvency proceedings.

Regarding secured claims, see **7.1 Impact of Insolvency Processes**.

7.3 Length of Insolvency Process and Recoveries

Civil rehabilitation proceedings take approximately five months for the entire process, based on the standard schedule of the Tokyo District Court of Japan.

A standard corporate reorganisation (where the insolvency trustee is appointed from outside the current management of the debtor) takes approximately eight to 11 months, while DIP-type corporate reorganisations typically take around five months.

That said, the actual length may significantly vary depending on the complexity and circumstances of each case. Corporate insolvency cases involving many creditors and a large amount of debt may take a longer time than the standard schedule mentioned above.

For the recoveries to creditors, see **7.1 Impact of Insolvency Processes** and **7.2 Waterfall of Payments**.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

In addition to judicial insolvency proceedings, private restructuring processes are very important. They are initiated by the borrower's lawyer and sometimes involve a third-party organisation specialising in private turnaround situations.

This type of process is chosen by a financially distressed debtor who would like to avoid the damage that would be caused by the public announcement of the commencement of statutory insolvency proceedings.

Given the private nature of this process, creditors' rights are not involuntarily impaired and unanimous agreement among major creditors is required in order for the debtor to implement its restructuring plan.

7.5 Risk Areas for Lenders

One of the notable risk areas for lenders in statutory insolvency proceedings is the risk of avoidance. The creation of a security interest by a financially distressed borrower may be invalidated (by the insolvency trustee or the debtor-in-possession) if the security interest was created to secure existing debt:

- after the filing of an insolvency petition against the borrower (and the creditor knew that the petition had been filed);
- during the period when the borrower is "unable to pay" (ie, unable to pay its debts generally when they fall due) and the creditor knew that the borrower was unable to pay – or that the borrower did not pay – its debts generally when they fell due; or
- 30 days or less before the borrower became "unable to pay" and the borrower voluntarily created the security interest in favour of a specific creditor, and the creditor knew that the creation of the security would prejudice other creditors.

The perfection of a security interest may also be avoided even where the creation of a security interest itself may not be avoided pursuant to the criteria above. This is to prevent the holder of a security interest that has been hidden for a long time from obtaining priority over general creditors after the borrower becomes financially distressed. The requirements of such avoidance include the perfection:

- being made after the suspension of payments or the filing of an insolvency petition; and
- not being made within 15 days of the creation of the security interest.

Obtaining a guarantee or receiving a payment may become subject to the risk of avoidance under certain circumstances.

8. Project Finance

8.1 Recent Project Finance Activity

Following the nuclear power crisis caused by the Great East Japan earthquake in 2011, the electricity industry has changed drastically. Renewable energy has drawn increasing attention as an alternative energy source. The Japanese government has accelerated this movement by introducing the feed-in tariff in 2012. Although the focus is shifting from photovoltaic to other power sources (such as wind, geothermal and biomass), renewables projects remain one of the highlights of the Japanese project finance market. However, the suspension of operation

of nuclear reactors has made the country more dependent on fossil fuels. Thermal power projects are another recent highlight in this field, although the Ministry of Environment has concerns about carbon emission control.

A substantial portion of existing Japanese social infrastructure was constructed during the 1960s and 1970s. To meet the need to renovate and replace these facilities in the coming decades, the Japanese government is facilitating the use of PPP/PFI structures, another trend that market participants are focusing on.

8.2 Public-Private Partnership Transactions

The most notable recent area of Japanese PPP transactions is airport concessions. Concession rights have been granted for some major airports, including Kansai airport, Osaka airport, Fukuoka airport and Shin-chitose (Sapporo) airport.

The PFI Act and the Airport Concession Act are the most relevant pieces of legislation to airport concessions. Under these Acts, a public authority that administers public facilities confers the right to operate the airport facilities on a concessionaire, who is then allowed to charge users fees for using the airport facilities. The ownership of the airport facilities and land is retained by the government.

Since concessions are new in the market, the negotiation and documentation is less standardised. Private parties, together with government authorities, are working to establish new market practice.

Airports are not the only type of facility that can be privatised by the concession method. Toll roads and water and sewage systems are hopeful areas, some of which have already been privatised by way of concession.

8.3 Governing Law

The project documents are typically governed by Japanese law and the designated venue for dispute resolution would be the Japanese court as long as the project is located in Japan. However, transaction parties may choose another governing law (including English or New York law) or dispute resolution clause, including international arbitration.

8.4 Foreign Ownership

Generally, there are no legal restrictions on the ownership of real property in Japan by foreign entities, except that non-residents may be required to make a post-transaction filing pursuant to the Foreign Exchange and Foreign Trade Law.

Generally, when a foreign investor acquires shares in a project company in Japan, only a post-transaction filing is required pursuant to the Foreign Exchange and Foreign Trade Law. However, when the project company is engaged in certain types of business, including electricity, gas, oil, telecommunications, water supply, and transportation, the foreign investor is required to make a filing 30 days prior to the investment. In response to the filing, the government may order a suspension of, or change to, the investment if it is perceived as a threat to national security. Also, there are some specific industries where there is an upper limit to foreign ownership, such as aviation and telecommunications. Such restrictions may be obstacles to foreign lenders acquiring pledged shares by virtue of the exercise of security interest.

To use river water, permission must be obtained from the central or local government under the

River Act. Permission can be obtained by a foreign entity.

8.5 Structuring Deals

The most common legal forms of a project company are stock corporations (*kabushiki kaisha*) and limited liability companies (*godo kaisha*). A stock corporation is the most general form of corporation, and a limited liability company is a more summary form.

If the lender provides the project company with a commitment line and would like to rely on the exemption under the Commitment Line Act (see **3.10 Usury Laws**), the project company cannot be a limited liability company.

There are no material restrictions on foreign investment in a stock corporation or a limited liability company, other than notification under the Foreign Exchange and Foreign Trade Act.

8.6 Common Financing Sources and Typical Structures

Bank facilities are the major sources of financing for domestic projects.

8.7 Natural Resources

Mining natural resources such as oil, natural gas and minerals may be subject to a licence requirement under the Mining Act and other relevant regulations. The export of natural resources is not subject to any special restrictions under the Foreign Exchange and Foreign Trade Act.

Under the Foreign Exchange and Foreign Trade Act, a prior notification to the government should be filed with respect to any foreign investment in a Japanese company that is engaged in the operation of certain types of infrastructure, such as electricity generation. There is a 30-day waiting period from the date of the receipt of the notification, which may be shortened to two weeks in the absence of any substantial issues. During this period, the government will review the proposed investment, taking national security, public order and public safety into consideration.

8.8 Environmental, Health and Safety Laws

The basic environmental policy of Japan is set out under the Basic Environment Act. There are also various additional environmental, health and safety laws, such as the Air Pollution Control Act, the Water Pollution Control Act, the Soil Contamination Countermeasures Act, the Noise Regulation Act, the Vibration Regulation Act, the Industrial Water Act, the Offensive Odour Control Act, the Waste Management and Public Cleaning Act, and the Environment Impact Assessment Act.

Most of these Acts are administered by the Ministry of Health, Labour and Welfare, and the Ministry of Land, Infrastructure, Transport and Tourism.

Trends and Developments

Contributed by:
Hikaru Naganuma and Wataru Ishii
Anderson Mori & Tomotsune

Anderson Mori & Tomotsune (AMT) is a full-service law firm which has the capability to serve a multinational client base on inbound, outbound and domestic projects by providing expert, timely and cost-efficient advice across a full range of legal issues, and in the largest, most complex, cross-sector transactions. AMT is proud of its long tradition of serving international business and legal communities and its reputation as one of the largest full-service law firms in Japan. AMT's combined expertise enables it to deliver comprehensive advice on virtually all legal issues that may arise from a corporate transaction, including those related to M&A, finance, capital markets and restructuring/insolvency, and litigation/arbitration. AMT is headquartered in Tokyo. Outside Japan, AMT has offices in Beijing, Shanghai, Singapore, Ho Chi Minh City, Bangkok, Hanoi and London. AMT also has associated firms in Hong Kong, Jakarta and Singapore.

Authors

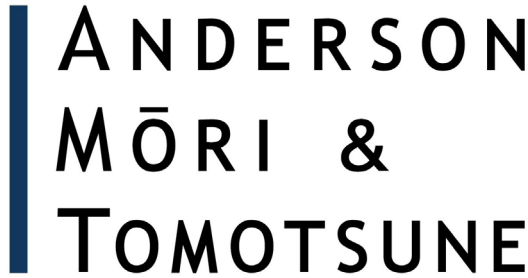
Hikaru Naganuma is a partner at Anderson Mori & Tomotsune who has been engaged in an extensive range of corporate matters, with an emphasis on securitisation of real properties and receivables, project finance, syndicated loans, real estate transactions and M&A transactions. He has also assisted both domestic and overseas clients in a variety of cross-border transactions in the areas of real estate investment, banking and corporate acquisitions.

Wataru Ishii is a partner at Anderson Mori & Tomotsune who has been engaged in an extensive range of corporate matters, especially focusing on financial transactions including project finance, private finance initiatives, real estate finance and structured finance.

Anderson Mori & Tomotsune

Otemachi Park Building
1-1-1 Otemachi
Chiyoda-ku
Tokyo
100-8136
Japan

Tel: +81 3 6775 1214
Fax: +81 3 6775 2214
Email: hikaru.naganuma@amt-law.com
Web: www.amt-law.com/en/



General Overview of the Residual Effects of COVID-19 on Japan

Until 2022, the COVID-19 pandemic was one of the significant concerns in the Japanese financial market. However, from 8 May 2023, the classification of COVID-19 was downgraded to that of a common infectious disease in Japan. Against this backdrop, economic activities have been returning to normal, and the Japanese financial market has been showing a robust recovery led by a growing appetite of foreign investors against the backdrop of a depreciating yen and a low interest rate environment in Japan.

Monetary Easing Policy of the Bank of Japan

The Bank of Japan (BOJ), the central bank of Japan, has adopted a policy of dramatic monetary easing in recent years to stimulate the Japanese economy. This has continued in light of the significant disruptions to the Japanese and global economy as a result of the COVID-19 pandemic. According to the Statement of Monetary Policy published by the BOJ on 28 July 2023, the BOJ decided to continue its policy of monetary easing. As part of this policy, the following, among other measures, have been adopted:

- with respect to short-term interest rates – the application of a negative interest rate of minus 0.1% to the Policy-Rate Balances in the current accounts held by financial institutions with the BOJ; and
- with respect to long-term interest rates – the purchase by the BOJ of such amount of Japanese government bonds (JGBs) without any upper limit as is necessary for the ten-year JGB yield to remain at around 0%.

The BOJ also announced that the method of yield curve control will be conducted with an aim to keep fluctuation of long-term interest rates within a degree of approximately 0.5%, which would virtually act to allow more flexibility on increase in long-term interest rates going forward.

Recent Trends and Developments in Financial Markets

Real estate finance

Market trend overview

During the COVID-19 pandemic, the real estate market in Japan was adversely affected by the uncertainty surrounding tourism. In particular, some hotel properties in Japan suffered from

a serious decline in cashflow due to a drop in occupancy rates and faced breaches of their financial covenants. However, there has recently been a growing interest in (commercial and residential) real estate investments in Japan, indicated by the greater demand among both domestic and foreign investors with surplus funds, who are looking beyond the pandemic curve. In fact, an increasing number of high-rise complex buildings are being constructed in urban areas including the Azabu, Yaesu and Nihonbashi areas in Tokyo, and fierce demand for development sites contributes to land prices in urban areas remaining high. Additionally, continuing demand for logistics properties and data centre facilities is expected, driven by the growth in e-commerce and cloud services.

Real estate security tokens

Security token offerings (STOs), an alternative form of fundraising under which security tokens representing certain rights are offered, has recently been in the spotlight in Japan.

In July 2021, a securities registration statement (SRS) was filed for the issuance of tokenised beneficiary interests in a trust pursuant to the Financial Instruments and Exchange Act of Japan. According to that SRS, the underlying asset of the relevant trust is a residential property in Tokyo. The tokenised beneficiary interests were underwritten by securities houses and distributed to investors. According to press releases, the offering is the first public offering of security tokens in Japan involving a trust with beneficial interest certificate backed by assets, made possible by co-operation between the relevant real estate company, trust bank and two securities houses, which came together to formulate a viable transaction structure. In 2023, security tokens have been gaining popularity as an established method for raising funds from individual investors and quite a number of financial institutions are entering into the market for this financial product.

Acquisition finance

Market trend overview

In 2020, several borrowers and their group companies were severely damaged due to the COVID-19 pandemic, following which they had to request waivers of breaches of financial covenants or emergency credit from lenders. In some cases, portfolio companies, including those with some of the largest-scale leveraged financings in Japan, have been forced into bankruptcy or civil rehabilitation. Due to this development, the terms of lending (including the financial covenants required by lenders) have temporarily increased in stringency, on top of increases to interest margins by around 50–100bps as compared to rates in the pre-COVID-19 market. In 2023, however, the leveraged buyout market has been active by virtue of the strong continuing interest by both domestic and foreign private equity (PE) funds in investment opportunities in Japan. Notably, there are signs that lenders, including the Japanese “mega banks” (MUFG Bank, Sumitomo Mitsui Banking Corporation and Mizuho Bank) are now gradually returning to pre-pandemic lending terms, but they are still seeking various ways to transfer credit risk.

Latest trends in leveraged buyout transactions

In July 2020, the Ministry of Economy, Trade and Industry of Japan (METI) published a paper entitled “Practical Guidelines for Business Transformations – Toward Changes to Business Portfolios and Organisations”. This paper, intended to encourage businesses to embrace business restructuring to achieve sustainable growth, has resulted in an increasing number of divestitures by Japanese conglomerates of their assets or non-core businesses (including divestment of

shares in their subsidiaries, both private and public, that operate such non-core businesses) to third parties, such as PE funds. In some of these transactions, Japanese sellers have committed to substantial reinvestments into divested businesses and continuing involvement in the management of those businesses.

It is also notable that there is a growing number of "going private" transactions effected by way of tender offer bid. Some of these transactions have been implemented by the management of target companies accepting co-investments from financial equity contributors, including PE funds.

From a financing perspective, co-investment structures of this kind present some practical hurdles, such as how certain values can be ascertained in the event of dead-lock situations. However, lenders have recently shown more flexibility when appropriate arrangements have been able to be made to secure their interests, such as ensuring that share pledges and other security interests are able to be enforced.

Variation in mezzanine financing methods

In Japan, multiple tranche senior loans (with both amortisation features and bullet repayment features) are the most typical method by which leveraged acquisitions are financed. Mezzanine financing is also a valid option for sponsors wishing to limit equity contribution amounts. Typically, mezzanine financing is made in the form of subordinated loans or preferred shares (whether convertible or otherwise). Recently, with more sponsors seeking higher leverage, mezzanine loans to the holding companies of borrowers in senior loans have been gaining in popularity. Such holdco mezzanine loans are structurally subordinated to the senior loans, as a result of which no intercreditor agreement is generally required between the senior lenders and the holdco mezzanine lenders.

While the structure of holdco mezzanine loans varies depending on the time at which such holdco mezzanine loans are obtained, it is often the case that no security interest over shares in the senior borrower or target group companies is created in favour of the lenders of holdco mezzanine loans, in order to avoid any conflict with security interests in favour of senior lenders. In some transactions, lenders have the right to require a borrower to dispose of its shares in the senior borrower upon the occurrence of an event of default, to the extent that the exercise of such mandatory disposal right does not conflict with the interest of the senior lenders.

Project finance

Market trend overview

The impact of the COVID-19 pandemic on the financing of renewable energy projects has been limited, compared to other types of financing. This is mainly because the pandemic has not had an adverse effect on electricity prices under the Feed-in Tariff system in Japan.

Promotion of offshore wind power projects

The Japanese government intends to expand domestic electricity supply from offshore wind power-generation facilities. According to the Vision for Offshore Wind Power Industry (1st) published on 15 December 2020, the Japanese government set the following targets for the enhancement of the offshore wind power industry:

- the development of offshore wind power projects of 10 million kW or more by 2030; and
- the development of offshore wind power projects, including floating offshore wind power

projects, of between 30 million kW and 45 million kW, by 2040.

To promote offshore wind power projects, the Act on Promoting Utilisation of Sea Areas for the Development of Marine Renewable Energy Generation Facilities of Japan (the "Marine Renewable Energy Act") came into effect on 1 April 2019. Under the Marine Renewable Energy Act, the Minister of Economy, Trade and Industry and the Minister of Land, Infrastructure, Transport and Tourism designate certain sea areas that conform to certain criteria as promotion zones for the development of marine renewable energy generation facilities (each a "Promotion Zone") and a business operator who will develop and operate offshore wind power-generation facilities in a Promotion Zone is designated through a public tender process.

As of 31 July 2023, business operators have been designated for each of the following Promotion Zones:

- the sea area off the shore of Noshiro City, Mitane Town and Oga City, Akita Prefecture;
- the sea area off the shore of Yurihonjo City, Akita Prefecture (northern side);
- the sea area off the shore of Yurihonjo City, Akita Prefecture (southern side);
- the sea area off the shore of Choshi City, Chiba Prefecture; and
- the sea area off the shore of Goto City, Nagasaki Prefecture.

In addition, public tender processes for the following Promotion Zones are being carried out and the business operators for each of those Promotion Zones will soon be designated:

- the sea area off the shore of Happo Town and Noshiro City, Akita Prefecture;
- the sea area off the shore of Oga City, Katagami City and Akita City, Akita Prefecture;
- the sea area off the shore of Murakami City and Tainai City, Niigata Prefecture; and
- the sea area off the shore of Ejima, Saikai City, Nagasaki Prefecture.

The amount of project financing for offshore wind power projects is expected to increase as the Japanese government continues to encourage the development and expansion of the offshore wind power business and projects in Japan.

Solar power projects

The development of large-scale solar power projects may become less attractive to investors because of the reduction of the expected sales price of electricity applicable to recently certified projects. However, the purchase and sale of already developed solar power projects with favourable Feed-in Tariff conditions are active.

One of the recent topics regarding solar power projects is the introduction of decommissioning reserves. A solar power project of 10kW or more is required to reserve the costs of decommissioning of solar power plants in the last ten years of the Feed-in Tariff or Feed-in Premium period applicable to the project. Calculation of the amount to be reserved is based on the designated amount per kWh. Although the reserve amounts are maintained by the Organisation for Cross-regional Co-ordination of Transmission Operators, Japan, in principle, internal reserves are allowed if certain requirements are met.

Other renewable power projects

Project finance transactions for other renewable power projects have also been active. One of the examples is a project finance transaction for a geothermal power project in Kumamoto Prefecture in June 2021, which was publicly

announced by the arranger bank. Although there would be possible risks peculiar to geothermal power projects such as:

- uncertainty of the amount of resources under a project site;
- limitations on the examination and development of a project site which is in an area designated as a national park or a quasi-national park; and
- acquisition and possession of rights to dig a project site to use hot water and steam that spring up from the ground, in co-ordination with local persons, such as those who operate and manage a hotel with hot springs,

it is expected that subsequent project finance transactions for geothermal power projects will be arranged in the near future.

Introduction of the Feed-in Premium Scheme

The Feed-in Premium scheme was introduced in April 2022, in addition to the existing Feed-in Tariff scheme. Under the Feed-in Premium scheme, revenue from renewable power projects consists of:

- revenue from transactions at the electricity exchange or pursuant to bilateral agreement; and
- premiums calculated in accordance with certain formulae.

The Minister of Economy, Trade and Industry designates the type of power sources to which the Feed-in Premium scheme is applicable.

ESG finance

ESG finance has been getting more attention from participants in the Japanese finance market.

For example, according to the Ministry of the Environment Government of Japan (MOE), the number of green loan deals has increased from one in 2017 to 180 in 2022. The Japanese government encourages expansion of ESG finance transactions by, for instance, issuing MOE guidelines for green loans, green bonds, sustainability-linked loans and sustainability-linked bonds. So far, the impact of ESG-related issues on the terms and conditions of acquisition finance documentation in Japan has been limited, but this is expected to change as ESG concerns grow in significance.

KENYA

Law and Practice

Contributed by:
Esther Omulele, Isaiah Kamau and Melissa Wango Were
MMC ASAFO

Contents

MMC ASAFO is a full-service commercial law firm based in Nairobi and Mombasa, Kenya, with seven partners and over 15 associates with experience in a wide variety of legal matters. MMC teamed up with international law firm ASAFO & CO., which has a presence in Nairobi, Mombasa, Paris, Casablanca, Abidjan, Johannesburg, London and Washington DC, to create the first real pan-African law firm with international expertise and "on-the-ground" experience in Africa. MMC specialises in an array of practice areas, including project development, advisory services and legislative drafting, project finance, real estate, banking, M&A, private equity, capital markets, IP, dispute resolution, and labour and employment. It has successfully handled complex transactions in sectors such as energy, infrastructure, oil and gas, mining, private equity, banking and insurance. The firm's commitment to excellence, meticulous attention to detail and unwavering dedication to client satisfaction make it a trusted adviser and partner of choice.

Authors

Esther Omulele is the managing partner and head of the commercial and property division of MMC ASAFO in Nairobi. She is a highly accomplished professional with over 25 years of experience and expertise in banking, fintech, project finance, capital markets, regulatory work and governance matters. She represents the top commercial banks in the country, including KCB Bank Kenya, ABSA Bank Kenya Plc, the Cooperative Bank of Kenya Ltd, Equity Bank (Kenya) Ltd, NCBA Bank Kenya Plc, UBA Bank Kenya Ltd, Family Bank Ltd and HFC Ltd. Esther was ranked by Chambers Global 2023 in the practice areas of Banking and Finance, and Real Estate.

Isaiah Kamau is the deputy managing partner and head of the banking and finance team at MMC ASAFO in Mombasa. He has a wealth of experience in banking, finance and fintech transactions, and represents the top commercial banks in Kenya, including KCB Bank Kenya Limited, ABSA Bank Kenya PLC, The Co-operative Bank Kenya Limited, Gulf African Bank Limited, NCBA Bank Kenya PLC, DIB Bank Kenya Limited, Equity Bank (Kenya) Limited and Family Bank Limited. Isaiah was recognised by Chambers Global 2023 as a leading lawyer in banking, finance and fintech.

Melissa Wango Were is a corporate commercial associate at MMC ASAFO, specialising in general corporate, banking, finance and fintech, projects and project finance, capital markets, data privacy and protection, IP, ESG and regulatory work. With a strong focus on these multifaceted domains, Melissa brings a comprehensive skill set to address a wide range of legal needs. This expertise positions her to provide adept guidance in navigating complex corporate transactions, financial matters, emerging technologies, regulatory compliance and the evolving landscape of data protection and ESG considerations.

MMC ASAFO

MMC Arches, Spring Valley Crescent
Off Peponi Road
Westlands
P.O. Box 79362-00200
Nairobi
Kenya

Tel: +254 720 585 785
Email: info@mmcasafo.com
Web: www.asafoandco.com

MMC ASAFO.

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

The most recent matters of note are the persistent inflationary pressures and the global economy. As of August 2023, the inflation rate is 8.68%, driven largely by the increase in fuel, food and non-fuel prices.

Consequently, the Monetary Policy Committee of the Central Bank of Kenya (CBK) resolved to tighten the Monetary Policy by raising the Central Bank Rate from 9.5% to 10.5%, in order to anchor inflation expectations. This has led most banks to increase their lending rates, falling between 13% and 20% pa.

This increase in interest rates comes at a time when there has been an increase in the number of non-performing loans (NPLs) from banks in the first quarter of this year; the CBK's Quarterly Economic Review, January–March 2023, estimated NPLs to be between KES487.7 billion and KES540.84 billion at the end of the fourth quarter of 2022. This has forced most banks to increase their loan provisions to cushion against possible defaults.

1.2 Impact of the Ukraine War

The Ukraine war introduced uncertainty and challenges for Kenya's economy, influencing borrowing patterns and terms in the loan market as individuals and businesses navigate the economic fallout and seek financial stability amidst these disruptions.

First, over the years Kenya and Ukraine have established diplomatic relations and engaged in trade, with a focus on agricultural products, among other matters. As such, due to the disruption in global trade caused by the conflict and sanctions against Russia, Kenya's key exports – such as tea, coffee and flowers – have experienced reduced demand, leading to decreased revenue for local businesses. This economic downturn has made it challenging for businesses to access loans as they face declining cash flows and profitability. In addition, the rising cost of imported goods, particularly oil and fertiliser, due to supply chain disruptions from Russia and Ukraine has led to inflationary pressures in Kenya. As a result, borrowers may be seeking loans to cover increased costs of living and production, which could potentially strain the credit market.

Second, the Kenyan government's response to the impact on the cost of living, such as implementing fuel stabilisation programmes and subsidising fertiliser prices, has understandably contributed to an increase in public debt. According to a 2023 Public Finance Management Regulation Amendments report, as of June 2023, public debt was roughly KES9.4 trillion. The increased demand for government loans or bonds in the local credit market has crowded out private borrowers and affected interest rates.

1.3 The High-Yield Market

The leading and most common high-yield market in Kenya is the bond market, which is characterised by lower funding costs for the issuer compared to the traditional lending market. The real estate investment trust (REIT) market is also active as an investment vehicle in the real estate sector. In the context of emerging markets like Kenya, the high-yield market has played a role in shaping financing terms and structures in several ways.

- Diversification of funding sources: market availability offers an alternative source of financing beyond the traditional bank loans or

equity markets. This diversification is particularly useful in times of credit market volatility or when access to traditional sources of funding is limited.
- Risk distribution: the market is characterised by multiple players (creditors and investors respectively) as opposed to a single player, which is one of the key features of traditional lending. The multiplicity of players is beneficial as it allows for risk distribution in case of default.
- Impact on financing terms: to attract investors, issuers have had to replace traditional terms with more flexible ones – eg, those allowing the repayment and redemption of bonds, instead of having a single maturity date on which an investor is repaid the principal of the bonds.

1.4 Alternative Credit Providers

Kenya's loan market has seen steady growth in alternative credit providers since the introduction of mobile money in 2007, which led to the emergence of the Digital Lenders Association formed by a group of fintech companies in 2019 and subsequently the gazettement of the Digital Credit Provider Regulations in March 2022.

This emergence of alternative lending solutions has eased small and medium enterprises' access to capital that would otherwise be unreachable from other financial institutions, due to the stricter vetting processes. These alternative lending institutions are more willing to provide unsecured credit to companies and instead tie them to their receivables. By factoring in the borrowers' electronic receivables (if a company) or transaction history (if an individual), these alternative credit providers can anticipate customers' propensity to repay and recognise any unusual or suspicious variance. This differs to the financing terms and structure of the traditional lenders, which factor in the borrower's transaction records and collateral. Moreover, alternative lenders have relatively more flexible payment terms.

1.5 Banking and Finance Techniques

Kenya's financial system has undergone major developments over the past few decades, to reflect the ever-changing investor and borrower needs and to align with global standards and the growing complexity of the payment system. Several notable banking and finance techniques have contributed to this evolution.

- Fintech innovations are increasingly offering digital solutions like online banking, mobile payments and digital lending.
- Alternative financing methods are gaining ground, with peer-to-peer (P2P) lending platforms connecting individual lenders and borrowers outside of traditional banks.
- Securitisation (converting loans into traceable securities) is diversifying risk and opening new investment avenues.
- Investors are increasingly valuing impact alongside returns, giving rise to impact investing and sustainable finance products.
- HoldCo structures are also increasingly preferred, as they can increase efficiency in access to and allocation of capital while enabling the equity markets to place appropriate value on a group's business separate from the banking operations to be undertaken by its subsidiary(ies). One example is the KCB Group, which obtained all regulatory approvals to transfer its banking business to its wholly owned subsidiary, KCB Bank Kenya Limited.
- Preferred equity has evolved to cater to the capital-raising needs of borrowers, offering flexible structures with dividend preferences, risk mitigation and the attraction of diverse

investors, including venture capitalists and private equity firms. It has become a valuable tool in the country's financial landscape, complementing traditional debt financing and common equity for companies seeking funding.

1.6 ESG/Sustainability-Linked Lending

One recent development in this sector is the increase in financial institutions in the Kenyan market focusing on promoting sustainable development through ESG-aligned lending practices to micro and small businesses in emerging markets that may not have access to traditional banking services. One example is 4G Capital, which has a client base of over 370,000 and successfully launched the Series C fundraiser in 2022, raising USD18.5 million, and lent over USD360 million. Another is IFC, which in 2023 partnered with and advanced a USD65 million sustainability-linked loan to fintech platform M-KOPA Holdings Ltd, to enable M-KOPA to expand its financial services to underbanked consumers in Eastern Africa.

2. Authorisation

2.1 Providing Financing to a Company

The key steps for banks and non-banks to be authorised to provide financing to a company in Kenya are as follows.

- Initial contact and name approval: begin by contacting the CBK for preliminary discussions on licensing requirements. Seek the CBK's approval for using relevant terms like "bank" or "finance" in the proposed entity's name.
- Incorporation: after name approval, incorporate the entity as a limited liability company through the Registrar of Companies.
- Application: apply to the CBK for the desired licence using the specific forms available on the CBK's website. Such forms include "Application form for a Licence to Conduct the Business of an Institution", "Fit and Proper" forms for directors and officers, and "Fit and Proper" forms for significant shareholders.
- Submission: provide the following along with the application:
  - (a) certified copies of incorporation certificates;
  - (b) Memorandum and Articles of Association;
  - (c) financial statements for the past three years (if applicable);
  - (d) personal statements of affairs for significant shareholders (if individuals);
  - (e) a non-refundable fee of KES5,000;
  - (f) sworn declarations signed by officers;
  - (g) a feasibility study covering the group structure, an organisation chart, the CVs of significant shareholders and officers, preliminary expenses, financial projections for three years, interest rate sensitivity analysis, operational arrangements and the relevant area data;
  - (h) sources and evidence of the availability of capital (currently, a minimum of KES1 billion is required);
  - (i) signed and sworn Anti-Money Laundering Statements by each individual and shareholder; and
  - (j) other required documents.
- Foreign institutions: for institutions incorporated outside Kenya, submit additional documents such as notarised copies of documents, an undertaking on capital maintenance, the contact details of designated liaisons, a letter of no objection from the home supervisory authority, and other relevant information.

- Approval in principle: after meeting the requirements, the CBK grants "approval in principle".
- Preparation: with approval, prepare premises, systems, facilities and staff.
- Inspection: invite the CBK for an inspection once ready. If the inspection is satisfactory, pay the prescribed annual licence fees.
- Licence issuance: upon fee payment, the CBK places a notice in the Kenya Gazette and issues the licence.
- Start operations: with the licence, the institution can open its doors to the public.

Note that non-deposit taking microfinance institutions are not regulated by the CBK. Such institutions need only a letter of no objection from the CBK when registering as private limited companies.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Foreign lenders are generally not restricted from granting loans to Kenyan private and public borrowers. The parties need only enter into a legally binding agreement containing the terms agreeable to both, including the applicable law governing the agreement.

However, there are several considerations to be aware of when foreign lenders engage in lending to government entities in Kenya. For instance, they may need to adhere to laws such as the Public Finance Management Act and regulations, securing approvals from relevant authorities and abiding by procurement regulations. Foreign lenders may also need to be mindful of the country's debt sustainability thresholds and parliamentary approval requirements for significant loans.

3.2 Restrictions on Foreign Lenders Receiving Security

The granting of security or guarantees to foreign lenders is not restricted. In Kenya, assets of all types may be the subject of security, including future and contingent rights, cash in accounts and interests under contracts. The parties can execute a security agreement over any security of the borrower as agreed between the parties to the agreement.

3.3 Restrictions and Controls on Foreign Currency Exchange

There are no restrictions or controls on residents and non-residents regarding foreign currency exchange. As such, they may:

- invoice for their goods and services in Kenyan shillings or foreign currency;
- possess foreign currency;
- sell foreign currency to, and buy it from, authorised dealers; and
- export and import currency in accordance with the Anti-counterfeit Act.

3.4 Restrictions on the Borrower's Use of Proceeds

There are no restrictions on a borrower's use of loan proceeds from legal activities. Kenya's legal framework on loans respects the contractual freedom of the parties to agree on the use of such earnings. However, the parties themselves may choose to include clauses that regulate the use of loan proceeds advanced to the borrower, particularly for specific loans such as construction loans. Some banks may require applicants to disclose the potential use of the loans subscribed to.

3.5 Agent and Trust Concepts

Kenya's legal framework appreciates the common law concepts of agency and equity trust relationships. Parties are at liberty to appoint agents and create trusts to preserve their interests in loan transactions. For instance, a syndication agent, usually a bank, will be appointed where more than one lender is issuing a loan to the borrower in a loan agreement. This agent is responsible for communication between the parties, and for managing the loan funds for the borrower. A party may also delegate authority through a power of attorney for the donee to act on their behalf where their physical presence will be adversely delayed or is unnecessarily expensive.

A trustee might be appointed in escrow agreements to maintain the interests of the beneficiaries of the funds in the escrow account. The Land Act also allows the chargee to appoint a receiver where the borrower defaults. The receiver may act as both an agent and a trustee of the lender, depending on the nature of the lender's instructions.

3.6 Loan Transfer Mechanisms

The main loan transfer mechanism in Kenya typically involves an assignment or transfer. When loans are transferred, the associated security package will also be transferred.

An assignment is subject to the terms of the loan agreement. The assignee assumes all the rights and obligations of the assignor, including the right to enforce the security in the event of default. The assignment will be made according to the instructions given in the assignment clause.

The transfer of the security package is closely tied to the assignment of the loan. The security package is governed by a security agreement between the borrower and lender. The transfer will be registered at the relevant registries – eg, the Companies Registry for charges over company assets, the Lands Registry for real property interests and the Collateral registry for movable assets.

3.7 Debt Buy-Back

A debt buy-back refers to the purchase by the borrower or a related party of its own debt from its lender(s), often at a discount. Effectively, the debtor's obligations are reduced while the creditor receives a one-off payment.

The term "debt buy-back", however, is not popularly known or used; instead, Kenyans use "early repayments" or "early redemption". An early repayment refers to where any borrower clears its loan before its term. Knowing that they may miss out on some of the interest that would have accrued for the entire term of the loan, some lenders may choose to include an early repayment penalty in the loan instrument. This is purely contractual, with the law tending to leave the parties to their own devices.

Early redemption, on the other hand, is most commonly used in securities markets. The Land Act grants the chargor the right to redeem its securities at any time before the loan term, and it is illegal to deny the borrower the opportunity to exercise this right. The principle is also embedded in the bonds sector, so that some companies repay the bond amount together with accrued interest earlier than the agreed date. The Public Finance Management (National Government) Regulations, 2015 recognise the early redemption of treasury bonds from funds placed in a sinking fund. The law allows the National Treasury to accept discounts to effect early repayment, subject to limitations under the law.

3.8 Public Acquisition Finance

"Certain Funds" Clauses

A "certain funds" clause requires a bidder making a takeover bid for a public entity to have sufficient funds to finish the takeover process; they guarantee "assurance" as to the financial capability of the acquirer. Notably, the Capital Markets (Takeovers and Mergers) Regulations (CMA Regulations) provide a standard global practice of these clauses. The regulations require the bidder to demonstrate their financial capacity, to ensure a successful takeover by paying all the consideration involved.

However, this "certain funds" requirement may be dealt with differently in instances of a preconditional offer (an offer is made if certain preconditions are met). Regulation 15 of the CMA Regulations provides that an offer that is conditional on a minimum percentage of shares being accepted (known as "minimum acceptance condition") must specify a date. This date cannot be later than 30 days from the date the takeover offer is served to the shareholders, unless the Capital Markets Authority allows an extension in competitive situations or special circumstances. This specified date is crucial because it is the latest date by which the offeror can declare that the condition has been met, and the offer is no longer subject to that condition.

Short-Form or Long-Form Documentation

In accordance with the CMA Regulations, long-form documentation is commonly used. The Regulations impose a duty on the acquiring entity to disclose information such as its identity, the shareholding and prior agreements made.

Public Filing of Documentation

Documentation in a public acquisition finance transaction is publicly filed. The acquirer is obliged to announce its proposed offer by press notice, and to serve a notice of intention to the target company, the Nairobi Securities Exchange, the CMA and Monopolies and Prices Commission within 24 hours from the acquisition board resolution. In addition, the acquirer is under a continuous reporting obligation to make a cautionary announcement of any information that may lead to a material change in the price of shares, if at any time the necessary degree of confidentiality has been breached or cannot be maintained.

3.9 Recent Legal and Commercial Developments

The Finance Amendment Act, 2023 has brought an array of changes to Kenya's economic spectrum, in a bid to revitalise the economy by seeking to offer businesses breathing space and increase the tax net. This is in line with the government's agenda to jump-start the economy, especially due to the damaging consequences of the COVID-19 pandemic, the Russia–Ukraine war and the existing huge public debts.

The changes in the Act have affected the imposition of income tax, VAT, excise tax and various fees and penalties, as well as general tax compliance requirements. A foreign entity seeking to invest in Kenya should be aware of the changes, including:

- the reduction of corporate income tax rate for a branch/permanent establishment (PE) from 37.5% to 30%;
- the introduction of branch/PE tax of 15% in addition to the income tax chargeable on the branch;
- the ability of foreigners to defer FX losses and claim them back within five years from the date of the loss;

- the payment of capital gains tax where a foreigner intends to transfer 20% of their shares in a company; and
- the domestication of inter-state agreements in a bid to bolster tax collection assistance.

Essentially, the legal documentation has changed to reflect what the Amendment Act has introduced.

3.10 Usury Laws

Usury refers to the act of lending money at an interest rate that is considered unreasonably high or higher than the rate permitted by the applicable law. Usury laws specifically target the practice of charging excessively high interest rates on a variety of loans by setting caps on the maximum amount of interest that can be levied.

There are currently no interest cap laws in Kenya, following its removal from the Banking Act (Section 33B) in 2019. However, pursuant to Section 36 of the Central Bank of Kenya Act, the CBK regulates the lowest interest rate banks may charge, which as of July 2023 stood at KES10.50.

Furthermore, in Islamic banking, Sharia restrains banks from attaching riba (interest or usury) on loans.

In Diplum Rule

This rule (which means "in double") provides that interest stops running when unpaid interest equals the outstanding capital amount. As such, while the rule does not prevent the lender from earning interest on the principal more than the loan itself, the lender should never recover more interest than the principal amount owing. This rule is captured in Section 44A (3) of the Banking Act (Chapter 488 Laws of Kenya).

3.11 Disclosure Requirements

There are sector-specific rules and laws that regulate the disclosure of certain financial contracts, particularly those related to securities and investments, as follows.

- The Companies Act requires companies to comply with the prescribed financial accounting standards when making disclosures in their financial statements, including financial statements about employees such as the monthly average number of employed persons, wages and salaries, and costs incurred in respect of retirement and other benefits. Public companies are subject to more stringent disclosure requirements than private companies.
- The Capital Markets Act, CAP 485A and the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002 set out guidelines for the timely and accurate disclosure of information to the public, including details of the securities, financial performance and any material events that could influence an investor's decisions.
- The Nairobi Securities Exchange (NSE) Listing Rules set the disclosure requirements for the listing of securities in the market segments.
- The REIT regulations set the disclosure requirements for REITs issuers seeking to list REIT securities.
- The Banking Act, CAP 488 requires banks to disclose their financial statements and other information to the CBK and other relevant authorities.
- Sections 59 to 66 of the Insurance Act require insurance companies to disclose all relevant information to the Insurance Regulatory Authority and to policyholders.
- The Capital Markets (Collective Investment Schemes) Regulations, 2001 outline disclosure requirements for collective investment

schemes, including mutual funds and unit trusts.
- The Anti-Money Laundering Regulations require financial institutions to conduct due diligence and maintain records on their clients, including information about financial transactions.

4. Tax

4.1 Withholding Tax

Payments of principal, interest or other payments made to lenders are subject to withholding tax (WHT). The rate depends on whether the lender is a resident or non-resident.

4.2 Other Taxes, Duties, Charges or Tax Considerations

When advancing loans to borrowers or taking security and guarantees from borrowers, the taxes, duties, charges or tax considerations that will be relevant for the lender to note will include:

- stamp duty, which will be applicable in transactions involving loan agreements, mortgages and guarantees, with rates determined by the transaction's nature; and
- capital gains tax, which may arise during security or guarantee transactions involving property or asset transfers.

Other tax-related factors include:

- the thin capitalisation rules limiting the amount of interest expense that can be deducted for tax purposes if the debt-to-equity ratio of a company exceeds a certain threshold;
- transfer pricing regulations requiring transactions between related parties to be on arm's length terms;
- foreign exchange controls that could impact the repatriation of loan-related funds in foreign currency; and
- treaty considerations, which may impact the tax rates on interest payments.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Tax concerns when foreign lenders are involved include the following:

- WHT: this is one of the main concerns when dealing with foreign lenders. Kenya imposes 15% WHT on interest payments made to foreign lenders, which impacts the effective yield for the foreign lender.
- Thin capitalisation rules: these rules are designed to prevent excessive interest deductions on loans from related parties or foreign lenders. In Kenya, a company is deemed to be thinly capitalised where the gross interest paid or payable by the company to related persons and third parties exceeds 30% of the company's earnings before interest, taxes, depreciation and amortisation (EBITDA) in any financial year. If a company has a high level of debt in comparison to its equity, interest payments on the excessive debt might not be fully deductible for tax purposes.
- Transfer pricing: the Income Tax Act CAP 470 and the Transfer Pricing Rules, 2006 regulate the tax implications on, among others, loan agreements between related companies. Such implications impact the deductible interest expense.
- Permanent establishment: if a foreign lender has a physical presence or conducts certain activities in Kenya that meet the criteria of a "permanent establishment" under tax treaties or local laws, the lender could be subject to

taxation in Kenya on the income attributable to that permanent establishment.
- Foreign exchange gains and losses: fluctuations in foreign exchange rates can impact the cost of servicing foreign-denominated loans. Exchange rate gains or losses could also have tax implications.

Mitigation strategies include the following.

- Tax treaty consideration: if there is a tax treaty between Kenya and the lender's country, it might specify a reduced withholding tax rate on interest payments. Ensure that the lender is eligible for any benefits under the treaty.
- Transfer pricing documentation: ensure that the terms of the loan are supported by proper transfer pricing documentation, demonstrating that they are consistent with arm's length principles.
- Thin capitalisation planning: evaluate the debt-to-equity ratio to avoid falling foul of any thin capitalisation rules. It might be beneficial to increase equity funding if necessary.
- Proper structuring: consider the overall business structure to mitigate risks related to permanent establishment and other potential tax liabilities.
- Foreign exchange risk management: implement strategies to manage foreign exchange risk, such as using appropriate hedging instruments.
- Professional advice: engage with tax professionals who have expertise in both Kenyan and international tax laws. They can help navigate the complexities and ensure compliance.

5. Guarantees and Security

5.1 Assets and Forms of Security

Assets Available as Collateral to Lenders

In Kenya, virtually all assets qualify as securities. Various lending institutions employ different thresholds for what is acceptable as collateral for the credit they offer. Broadly, the assets are separated into the following categories.

Real property

- Security form: legal charge.
- Formalities: as per Section 56 of the Land Registration Act (LRA), the charge instruments should be in a prescribed form.
- Perfection: payment of stamp duty and registration at the relevant registries. Registration automatically confers statutory compliance.
- Consequences: failure to register will render the charge unenforceable against liquidators, administrators or other secured creditors of the security provider. However, pursuant to Section 36 of the LRA, failure to register the charge instrument does not prevent said instrument from operating as a contract between the parties.
- Timing and costs: Section 36(4) of the LRA implies that the charge instrument should be presented for registration within three months from that date of the instrument, otherwise an additional fee, equal to the registration fee, shall accrue. Costs are applicable in each of the following five stages of the registration process:
  (a) Search: search at the Companies Registry takes one to three working days, depending on the availability of the file, and the maximum cost is KES3,000. Search at the Land Registry takes five days, depending on the availability of the file, and the maximum cost is approximately KES2,500.
  (b) Completion documents: facilitating reg-

istration takes approximately five working days, involving external lawyers and potential extra expenses based on the transaction value and fee scales. Essential completion documents include the Rates Clearance certificate (not mandatory) issued at a fee that depends on the county in which the land is located; the land rent clearance certificate (not mandatory); consent of the commissioner of Lands; and Land Control Board approval.

(c) Stamp duty: the duty is 0.1% of the financed amount, and the stamping process takes about two days.

(d) Registration: takes approximately seven working days and costs approximately KES8,500 at the Lands Registry and according to the 9th Schedule to the Companies Act (General) Regulations, 2015 at the Companies Registry.

Movable property

- Security form: chattels mortgage, credit purchase transaction, credit sale agreement, floating and fixed charge, pledge, trust indenture, trust receipt, financial lease and any other transaction that secured payment including an outright transfer of a receivable.
- Security right: security agreement, provided the grantor has the rights in the asset encumbered or the power to encumber it. The agreement may also provide for the creation of a security right in a future asset, but that security right is created only at the time when the grantor acquires rights in it or the power to encumber it.
- Formalities: the security agreement must be in writing and signed by the grantor, identify the parties, adequately describe the collateral by its specific listing, category, type and quantity, and, except in agreed cases of the outright transfer of a receivable, describe the secured obligation.
- Perfection: filing an initial notice with the Registry. One notice is sufficient for security rights granted by one grantor under multiple security agreements.

5.2 Floating Charges and/or Similar Security Interests

Kenyan law recognises the creation of a floating charge over all present and future assets of a company. Applicable laws include the Companies Act 2015, the Movable Property Security Rights Act 2017 (MPSRA) and the Insolvency Act, No 18 of 2015.

5.3 Downstream, Upstream and Cross-Stream Guarantees

In Kenya, under Section 173 of the Companies Act, entities can give downstream, upstream and cross-stream guarantees. Except for corporate approvals, no statutory approvals are required for a company to give a guarantee or provide security in connection with a loan or quasi-loan made to an associated body corporate.

However, such guarantees must still meet the commercial interests of the guarantor company. Associated limitations in respect of the guarantees include proof of benefits to each individual company granting a guarantee. In practice, board minutes that specifically state the commercial benefit to the grantor company will suffice.

5.4 Restrictions on the Target

The prohibition on a private company providing financial assistance for the purchase of its shares was abolished by the Companies Act when it came into force in 2015. As such, there are no rules prohibiting the target in a private acquisi-

tion transaction from giving financial assistance to the acquirer.

However, public companies are prohibited from giving financial assistance primarily for the acquisition of their own shares: Section 442 of the Companies Act, 2015 restricts the provision of assistance for the acquisition of shares in a public company, while Section 443 restricts the provision of assistance by a public company for the acquisition of shares in its private holding company. Section 444 treats such acts as offences.

5.5 Other Restrictions

Other restrictions and consents include the following:

- the articles of association may restrict a company from borrowing certain amounts;
- consent from the National Lands Commission is required if the proprietor has leased land from the government and intends to use it as security;
- the lessor's consent is required where land is leased from a lessor;
- spousal consent is required where the asset is matrimonial and an immovable property; and
- consent from the management company is required where there is separate ownership of units.

5.6 Release of Typical Forms of Security

Section 85 of the Land Act provides that an encumbrance on immovable property is released through a discharge, including re-conveyance and re-assignment of the charge or any other instrument used in extinguishing interests in land conferred by charges.

With respect to debts registered with the Companies Registry, security release is occasioned through a "memorandum of satisfaction" and "memorandum of release". The former is filed to show evidence of payment of the secured sum in whole or partly, while the latter is recorded when the encumbered property has been released from the charge.

Finally, for securities registered at the Collateral Registry, under Section 57 of the MPSRA a cancellation notice is registered when the secured interest has terminated.

5.7 Rules Governing the Priority of Competing Security Interests

In Kenya, the priority of competing security interests is primarily governed by the Companies Act, the Insolvency Act, the Land Act and the MPSRA. The priority rules dictate the order in which creditors are paid in the event of a bankruptcy, insolvency or liquidation. The key rules governing the priority of competing security interests are as follows.

- Secured v unsecured: secured creditors usually have a higher priority than unsecured creditors.
- Fixed v floating charges: fixed charges take priority over floating charges. Fixed charges are specific to particular assets and create a direct claim over them, while floating charges cover a company's assets as a whole, and their value "floats" until crystallisation.
- Registration: the date of registration of charges is key in determining the priority of charges.
- Pari passu principle: two or more creditors on the same subject may elect to have their security rights treated equally, regardless of the general rules on priority.

- Subordination: methods of subordination vary depending on the registering regime. For instance, where land is a security, Section 82 of the Land Act provides for the "doctrine of tacking," which paves the way for a first charge to have a further advance charge made to the same chargor to rank higher than a second charge. This method of subordination is only exercisable if the first chargee reserved the right to tack in the charge instrument. Where movable assets are security, Section 51 of the MPSRA allows a creditor who is devoid of temporal restrictions to vary their rank in the priority order in favour of any existing or future claimant.
- Contractual variation: priority can also be contractually varied, usually through either a subordination agreement or an intercreditor agreement, and such provisions will survive the insolvency of the borrower.

5.8 Priming Liens

In the context of lending and secured transactions, a "priming lien" typically refers to a lien that takes priority over existing liens or security interests. This means that the holder of the priming lien has a higher ranking claim in case of default, potentially pushing existing creditors down the priority ladder. Priming liens can be created by operation of law (the Companies Act and the Insolvency Act) or by agreement between the parties.

Priming Liens by Operation of Law

- Purchase Money Security Interest (PMSI): a PMSI arises when a lender provides financing to a debtor specifically for the purpose of acquiring certain collateral. A PMSI can prime existing security interests, giving the lender a superior claim to the collateral. This is often seen in the context of financing the purchase of goods like equipment or inventory.
- Possession and control: in some cases, taking physical possession of collateral such as title documents and logbooks as liens can give a lender a priming position. Upon default, the lender is at liberty to dispose of such liens.

Structuring Around Priming Liens in Kenya

- Collateral prioritisation: lenders can structure their loans to ensure that their security interest covers specific collateral, allowing them to take advantage of PMSI provisions. By providing financing expressly for the purchase of certain assets, the lender can establish a PMSI, which may prime other security interests.
- Agreement with existing creditors: if a lender intends to prime existing liens, they can negotiate with the current creditors to obtain their consent for the new security interest. This might involve offering some form of compensation or inducement to the existing creditors to agree to the arrangement.
- Notification and registration: in Kenya, secured transactions usually involve registration with a registry. Properly registering a security interest can help establish the priority of the lien.
- Contractual agreements: parties can structure loan agreements to define the order of repayment in case of default, including which liens will have priority. This can be a negotiated arrangement between the lender and borrower, as well as any other creditors involved.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Typically, transaction documents in each secured lending transaction set out the basis upon which

the secured party can enforce its security. Each security agreement must therefore specify the events that are to constitute events of default, primarily where a borrower fails to pay the secured loan amount or perform a secured obligation.

For immovable property, a power of sale application of the collateral will arise when an event of default occurs. However, this power is not exercisable unless the secured party has served a default notice on the debtor, specifying the particular event of default and what to do to rectify it, within two months for a default on obligations and three months for a default on payment. The security agreement can (but need not) provide that the power of sale or application is only exercised on the authority of an order of the Kenyan courts with sufficient jurisdiction.

For movable assets, a party may enforce its rights under the MPSRA, the security agreement or any other applicable law. Section 82 of the MPSRA provides that the law applicable to the enforcement of a security right in a tangible asset is the law of the country where the relevant act of enforcement takes place, while the enforcement of a security right in an intangible asset is the law applicable to the priority of the security right.

Methods, Procedures, Restrictions and Concerns

Enforcement methods differ depending on the type of security.

Charges

The Land Act and the LRA govern the enforcement of rights over immovable property, while the MPSRA governs movable property through charges after a default. The chargee may:

- sue for the amount due or owing (if applicable);
- appoint a receiver of the income of the real property/collateral;
- lease the land/immovable asset (if applicable);
- take possession of the land/collateral; or
- sell the land/collateral by private contract or public auction.

Enforcement through the sale of immovable property is subject to further requirements that must be met. First, the chargee must give the chargor 40 days' notice where it elects to sell the land by private contract. Where it elects to sell the land by public auction, the auctioneer is also required to give the chargor 45 days' notice and to publicly advertise the sale. In both options, the chargee must obtain a "forced sale valuation" of the land where it has a duty to obtain the best price reasonably obtainable at the time of sale.

Debentures

The terms of the debenture instrument will normally set out the enforcement procedure, including the appointment of a receiver and/or manager to undertake the procedure.

Guarantees

A claim under a guarantee can be made by providing a demand notice in accordance with the Deed of Guarantee. If the guarantor fails to make the payment, the guaranteed party can file a suit or enforce the guarantee through a summary procedure.

Charge over shares

The chargee can use a power of attorney and a share transfer form (both granted to it by the grantor after perfection) to transfer the shares to itself. The chargee must thereafter cause the share transfer to be stamped and notify the

Companies Registrar thereof. The company secretary of the transferee company must then register the chargee in the company's register of members.

There are restrictions on who can enforce a security interest over assets located in or governed by the laws of Kenya. However, the law will not stop the parties setting out any contractual restrictions or limitations in a security agreement that is applicable in the enforcement of security rights.

6.2 Foreign Law and Jurisdiction

Generally, parties to a contract retain the autonomy to choose the forum or jurisdiction that will govern the conduct of their contractual obligations and disputes that may arise out of that contractual relationship. This is in tandem with the principle of party autonomy. Such an arrangement is especially common with commercial contracts involving cross-border contracting parties.

However, this foreign governing law clause in contracts is not conclusive if its recognition would result in a breach of domestic public policy or an evasion of mandatory provisions of Kenyan law. There must be a real connection between the choice of foreign law and the contract to which it should apply.

6.3 Foreign Court Judgments

Enforcement of a Foreign Judgment

A foreign judgment can be enforced in Kenya without a retrial on the merits of the case only if it complies with the conditions set out in the Foreign Judgments (Reciprocal Enforcement) Act (Cap 43). The Act only extends such right to "designated countries": Australia, Malawi, Seychelles, Tanzania, Uganda, Zambia, the UK and Rwanda.

However, in the absence of a reciprocal arrangement, a foreign judgment is enforceable in Kenya as a claim in common law.

Enforcement of a Foreign Arbitral Award

In contrast with Cap 43, the Arbitration Act, 1995contemplates a much wider scope of enforcement. Section 36 stipulates that an international arbitral award will be recognised as binding and will be enforced in accordance with the provisions of the New York Convention or any other arbitration-related convention of which Kenya is a signatory. However, the court may refuse the enforcement of an arbitral award if the subject matter of the dispute is not capable of settlement by arbitration under the law of Kenya, or if the recognition or enforcement of the arbitral award would be contrary to the public policy of Kenya.

6.4 A Foreign Lender's Ability to Enforce Its Rights

Presuming that the loan or security agreement meets all the formal and legal requirements under Kenyan law, there are no special matters that may impact a foreign lender's ability to enforce its rights.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

The commencement of insolvency proceedings in Kenya can have a significant impact on a lender's rights to enforce its loan, security or guarantee. These impacts are governed by the Insolvency Act and regulations. Key considerations include the following.

- Automatic stay or moratorium: when an insolvency process is initiated, an automatic stay or moratorium comes into effect, restricting

lenders from taking any enforcement actions against the debtor. However, lenders holding security interests such as charges and mortgages may have the right to realise those assets to recover their debt, with the approval of the court or co-ordination with the insolvency practitioner.
- Priority of claims: the lenders shall be repaid in a specific order of priority. Typically, secured creditors holding a first fixed charge and preferential creditors will rank higher and their debts will be settled before creditors with floating charges. Unsecured creditors rank last, and may or may not recover their debts.
- Guarantees: if there is a guarantee present, the lenders may seek to enforce their rights against the guarantor. However, the guarantor's ability to fulfil their obligations will be contingent on their financing standing, and enforcement will also be subject to legal procedures.

7.2 Waterfall of Payments

Creditors are paid in the following order in insolvency proceedings in Kenya.

- Secured creditors have the highest priority and are paid from the proceeds of the sale of the specific assets they hold as security.
- The costs associated with the administration of the insolvency proceedings are paid next. These are referred to as first priority claims under the 2nd Schedule to the Insolvency Act.
- Preferential creditors: certain creditors are given preferential status and are paid before unsecured creditors. Pursuant to the 2nd Schedule to the Insolvency Act, these include employee claims for unpaid wages and salaries (capped at four months), as well as statutory deductions like taxes and contributions to employee pension funds.
- Unsecured creditors rank second to last in priority. The Insolvency Act requires that 20% of the net proceeds realised from the sale of assets subject to a floating charge is set aside exclusively for the benefit of unsecured creditors (known as the "prescribed part"), in addition to the amount that remains after settling the high-ranking creditors.
- Shareholders rank last, and are only entitled to a share of the remaining assets after all higher ranking creditors have been paid.

7.3 Length of Insolvency Process and Recoveries

The length and degree of recoveries can only be determined on a case-by-case basis, depending on several factors, including the party instituting the insolvency claim, the determination of the ascertained assets and liabilities of the insolvent undertaking, and the verification of the creditors and other persons with valid and recoverable claims under the proceedings.

In addition, where public interest issues arise, the proceedings may be protracted as the courts determine the applications and give a way forward.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

The Insolvency Act, 2015 allows for the following alternatives to insolvency for debtors in distress.

Administration

An administrator may be appointed by an administration order of the court, the holder of a floating charge or the company or its directors. The administrator would run the affairs of the company as a going concern and, where possible, salvage the business of the company and

pay the company's debt back to the greatest degree possible.

Company Voluntary Arrangement/Debt Restructuring

Part IX of the Insolvency Act allows the directors of a company to "make a proposal to the company and its creditors for a voluntary arrangement under which the company enters into a composition in satisfaction of its debts or a scheme for arranging its financial affairs".

The debtor company may enter into such an agreement for the repayment of its debts. This restructuring may be in the form of a debt-to-equity swap (as was the case for Kenya Airways), a debt-to-asset restructuring, recapitalisation or the transfer of good assets or business to a new entity.

An approved proposal is binding upon the company and the creditors as a voluntary arrangement but may be challenged where an eligible person challenges the arrangement on the basis that:

- the arrangement detrimentally affects the interests of a creditor, member or contributory of the company; or
- a material irregularity has occurred at or in relation to either of the meetings of the company or of the creditors, as convened under Part IX of the Insolvency Act.

7.5 Risk Areas for Lenders

The risk areas for lenders if the borrower, security provider or guarantor becomes insolvent are as follows.

- Priority of claims: in the event of insolvency, the creditors will be differentiated on their levels of priority when it comes to repayment. Secured creditors will have a higher priority than unsecured creditors. The lenders must therefore assess their position in the priority hierarchy to determine their likelihood of recovering the debt.
- Liquidation delays: the insolvency process can be time consuming and subject to delays. This may limit the lenders' access to funds tied up in the insolvency proceedings, possibly impeding their lending strength.
- Inadequate collateral value: the collateral provided by the borrower or security provider may not hold its expected value, leading the lender to not recover the full loan amount. The March 2023 High Court decision in the case of Home Afrika Limited v Ecobank Kenya Limited (Insolvency Cause No E010 of 2021) affirmed that if the asset provided as collateral or security fails to fetch a sufficient amount to settle the debt, a lender is barred from pursuing the guarantors.
- Prolonged search for a buyer: for instance, due to a less favourable property market in Kenya, it may take, on average, one year to successfully sell a property. This potentially delays the recovery of funds and impacts the lender's ability to mitigate losses promptly.

8. Project Finance

8.1 Recent Project Finance Activity

Project finance has developed as a crucial funding source for the development of critical infrastructure projects and for supporting economic growth in Kenya. Industries that are or are projected to be the most active users of this form of financing include transport and infrastructure (including energy), real estate and urban development, water and sanitation, industrial parks and manufacturing, and ICT, including intelligent management systems.

8.2 Public-Private Partnership Transactions

The Public Private Partnerships Act of 2021 is the primary legislation governing public-private partnerships in Kenya. There are a number of significant PPPs, with some still in the pipeline and others attaining financial closure, including:

- the ongoing tolling of the Nairobi-Nakuru-Mau Summit Road;
- the proposed construction of 500km power transmission lines under the IFPPP-AF Model;
- the proposed development of a Cancer Care Centre at the Meru Level 5 Hospital in Meru County, under the IFPPP-AF Model; and
- the ongoing construction of a 300-bed private hospital at the Kenyatta National Hospital.

8.3 Governing Law

With respect to project documents in the private sector, the parties are at liberty to choose any governing law and dispute resolution mechanism. The choice usually depends on the preferences of the parties, the perceived neutrality and efficiency of the chosen dispute resolution mechanism and any legal requirements or restrictions imposed. For instance, should parties agree to resolve their dispute in another contracting state and seek to enforce the decision, they will be subject to Kenyan laws on the recognition and enforcement of foreign judgments and arbitral awards.

However, project documents entered into by state organs or public entities have certain restrictions and/or qualifications. For instance, Section 71 of the Public Private Procurement Act, 2021 states that public-private partnership project agreements shall be subject to the provisions of the laws of Kenya, and that any provision in a project agreement to the contrary shall be void. Parties may agree in the project agreement to resolve any disputes through arbitration or any other non-judicial means.

Furthermore, for projects under the Public Procurement and Asset Disposal Act, 2015 (PPADA), disputes are referred to the Public Procurement Administrative Board. However, international agreements and treaties can be applied as the governing law. Where the PPADA conflicts with the country's obligations arising from a treaty, agreement or other convention ratified by the country, that treaty or agreement shall prevail.

8.4 Foreign Ownership

Land Ownership

Article 65 of the Constitution of Kenya, 2010 stipulates that non-citizens can only obtain a leasehold title over land in Kenya for a maximum of 99 years. A body corporate qualifies as a citizen only if it is entirely owned by citizens. In addition, the Land Control Act restricts non-citizens from owning agricultural land unless it is a leasehold.

Water Rights

The Water Act provides that every water resource is vested in the State and held in trust for the people of Kenya. Like citizens, foreign entities are required to obtain the appropriate permit or licence for the use of water resources, and to comply with the Water Act when using these water resources.

Remedial Rights

With respect to remedial rights over property, there is no distinction between foreign and local lenders. As such, foreign lenders can hold liens on property as part of loan agreements. However, exercising the remedial rights will require compliance with local laws and regulations, including the restrictions on the ownership of land by foreigners in Kenya.

8.5 Structuring Deals

When structuring a project finance deal in Kenya, several critical considerations must be addressed to ensure a successful and legally compliant arrangement, including:

- the choice of the amount of capital required for the project;
- the appointment of advisers (financial, legal, technical, insurance, environmental and market risk) to the project;
- the dividend policy;
- the respective roles in the project of each sponsor where there are more than one;
- management of the project vehicle; and
- the sale of shares and pre-emption rights.

Furthermore, the choice of the appropriate legal structure of the project company, whether a limited liability company or a limited liability partnership (LLP), is crucial for effective risk management and liability limitation. This decision intersects with Kenyan laws like the Companies Act and the LLP Act, which provide guidelines for establishing, managing and operating companies and LLPs, respectively. Other sector-specific laws shall apply, depending on the project sector.

Kenya's investment environment is fully liberalised. Foreign investors can invest up to 100% ownership, except in securities, banking, insurance, power and lighting, telecommunications and any other sectors identified by the government as posing a security risk to the country. Therefore, understanding sector-specific regulations is crucial in navigating any restrictions.

Finally, Kenya has ratified 21 bilateral investment treaties, nine treaties with investment provisions and 20 investment-related instruments.

8.6 Common Financing Sources and Typical Structures

Project financings in Kenya typically rely on a combination of financing sources and structures to secure the necessary funds for infrastructure and development projects. The choice of the financing will depend on factors such as the nature of the project, the risk profile, market conditions and the parties involved.

Traditionally, bank financing remains a prevalent choice, with commercial banks offering loans and credit facilities secured by project assets and cash flows. Export credit agency financings provide guarantees and loans (pre-shipment/pre-export finance) that facilitate local companies' international exports. For example, in May 2023, the Kenyan government and the African Export-Import Bank entered into a three-year programme for the latter's provision of up to USD3 billion in support of "viable trade and trade-related investment" in Kenya's public and private sectors.

Project bonds emerge as a versatile option, allowing projects to tap into capital markets for funding. These bonds are backed by the project's expected cash flows or assets, often attracting a broader investor base due to their longer tenures.

In addition to conventional financing, alternative sources cater to specific needs. Streaming or royalty financing involves selling future revenue streams for an upfront payment, primarily seen in resource sectors. Private equity funding allows firms to invest directly, infusing capital while often taking active managerial roles. Commodity trader financing, which is prevalent in resource-focused projects, exchanges upfront funding for a share of the project's future commodity production.

8.7 Natural Resources

The following issues and considerations are associated with natural resources projects in Kenya.

- Regulatory framework and compliance: understanding and adhering to the laws and bodies regulating aspects such as resource extraction, environmental impact assessments and project approvals is essential for the success of the projects.
- Environmental impact assessments: resource projects must undergo thorough environmental impact assessments to minimise ecological harm.
- Community engagement: engaging with local communities and obtaining their consent is essential to avoid conflicts and ensure social acceptance.
- Export limitations: an export permit from the Ministry of Petroleum and Mining must be obtained before undertaking mineral trade. The permit details the exporter (licensed dealer or miner), the value, weight, source and composition of the mineral, and the country and address of destination. For precious metals such as gold and precious stone such as gemstones, which are of high value but low volume, export permits are only issued by the Ministry after a mineral consignment has been seen, tested and, valued by a panel of officers, and the permit fees and royalties are paid to the government. The export of petroleum or crude products requires a licence from the Energy and Petroleum Regulatory Authority.
- Benefit and value addition: although not a statutory requirement, Kenya has expressed a growing interest in ensuring that more of the value from its natural resources is added within the country before export.

8.8 Environmental, Health and Safety Laws

Environmental Regulations

The Constitution of Kenya, 2010

This is the blueprint law regulating all project sectors. The Constitution guarantees universal access to the highest attainable standards of health under the Bill of Rights (Chapter 4). The role is allocated to the government of Kenya through the Ministry of Health.

The Environment Management and Co-ordination Act, 1999

This law sets the framework for environmental management in Kenya. The National Environment Management Authority (NEMA) is the regulatory body charged with the overall supervision and co-ordination of all matters relating to the environment, as well as the implementation of all policies relating to the environment. NEMA is responsible for dealing with environment impact assessment applications and approvals.

Health and Safety Regulations

Public Health Act, CAP 242

This Act sets the framework that secures and maintains the health of the public. The main regulatory body is the Minister of Health. The established Central Board of Health under the Act functions to advise the Minister upon all matters affecting the public health.

Occupational Safety and Health Act, No 15 of 2007 (OSHA)

This Act provides for the safety, health and welfare of workers and all persons lawfully present at workplaces, and establishes the National Council for Occupational Safety and Health. The overseeing regulator is the Director of Occupational Safety and Health Services.

Community Consultation Laws

The Constitution of Kenya, 2010

Public participation is one of the national values and principles of governance enshrined in the Constitution.

The Land Act, 2012

This Act outlines the requirements for community engagement and consultation when land being acquired or used for development will affect communities.

The Water Act

The abstracting of water for dams or other such use of water from a water resource requires a permit. Such permit is subject to public consultation and, where applicable, an environmental impact assessment.

Environmental impact assessment guidelines

The purpose of an environmental impact assessment is to guide project proponents and the public at large on effective planning that takes into account negative impacts of the project and alternative plans for the purpose of making prudent decisions.

LIECHTENSTEIN

Law and Practice

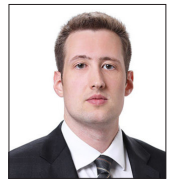
Contributed by:
Bernhard Rankl, Nicolai Binkert and Alexander Appel
Schurti Partners Attorneys at Law Ltd

Contents

Schurti Partners Attorneys at Law Ltd is a Liechtenstein-based full-service law firm with a strong focus on international matters. The firm's lawyers were trained and are qualified in several jurisdictions (Liechtenstein, New York, California, England and Wales, Ireland, Switzerland, Germany and Austria), and have gained work experience abroad in some of the most prestigious international law firms. The firm was founded in 1991 as a partnership and incorporated in 2015. Over the years, it has grown to become one of the largest and most renowned law firms in Liechtenstein. Schurti Partners has established a solid track record of supporting clients with businesses and/or assets across the world, drawing on the support of the firm's well-established networks of leading independent law firms based in other jurisdictions. Today, it is one of the leading Liechtenstein law firms in the area of banking and finance as well as regulatory matters.

Authors

Bernhard Rankl is an attorney-at-law in the banking/finance and commercial department of Schurti Partners Attorneys at Law Ltd. He focuses on banking and finance, regulatory, capital market, corporate, insolvency and restructuring-related matters and has extensive experience in advising lenders and borrowers on cross-border, large-scale financing transactions, with a particular focus on infrastructure, project, real estate and acquisition financings. Bernhard also regularly advises banks, insurance companies, payment service providers, investment service providers and fintechs in the context of licensing, governance, organisational and product-related matters, where he assists EEA and non-EEA clients navigating the complex EEA regulatory landscape.



Nicolai Binkert is a partner at Schurti Partners Attorneys at Law Ltd. He regularly advises lenders and borrowers on all types of complex cross-border financing transactions, including syndicated financing, acquisition financing, project financing, bond offerings and financial restructurings.

Alexander Appel is a partner at Schurti Partners Attorneys at Law Ltd and has more than 20 years of professional experience in the areas of banking and finance transactions as well as corporate law. His practice focuses particularly on cross-border corporate transactions, often with a regulatory element and complex finance transactions. He has advised both domestic and foreign banks, fund managers and corporate clients in a number of noteworthy financing transactions in Liechtenstein. Alexander also regularly advises international and renowned banks on regulatory issues such as cross-border licensing/passporting activities, M&A-related filings with the Financial Market Authority and cross-border marketing matters. He also practises as notary public in corporate law and other legal matters.

Schurti Partners Attorneys at Law Ltd

Zollstrasse 2
9490
Vaduz
Liechtenstein

Tel: +41 44 244 2000
Fax: +41 44 244 2100
Email: mail@schurtipartners.com
Web: www.schurtipartners.com

SCHURTI : PARTNERS
RECHTSANWÄLTE AG | ATTORNEYS AT LAW LTD

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Economic Cycles

Although Liechtenstein is internationally known for its financial and private wealth industry, it also has a strong manufacturing and industrial sector with a special focus on high-tech products in the fields of machine building, automotive industry and food products. As a small and open economy, Liechtenstein reacted particularly sensitively to the COVID-19-related slump in 2020, but recovered quickly on the back of a strong rebound in global trade. Switzerland and Liechtenstein form a common economic and monetary area, and Liechtenstein introduced the Swiss franc as its official currency in 1924. In 2022, the euro fell below parity relative to the Swiss franc. The strong Swiss franc made Liechtenstein less vulnerable to the sharp inflationary spikes that have plagued other European nations. Consequently, Liechtenstein has been insulated from the kind of market volatility commonly associated with rising inflation rates.

Regulatory Environment

Unlike its neighbour Switzerland, Liechtenstein has been part of the European Economic Area (EEA) since 1995 and therefore not only offers the same regulatory standard and framework as other European member states, but also grants full access to the EU markets. For this reason, Liechtenstein is often used by non-EEA, international companies as a "hub" for penetrating into the European markets. On the other hand, market participants also benefit from Liechtenstein's close ties with Switzerland, granting privileged access to the Swiss market. Liechtenstein is part of the Swiss franc monetary area, giving Liechtenstein financial institutions the same access to refinancing with the Swiss National Bank as Swiss institutions have.

The accessibility of the Liechtenstein loan market, coupled with the hands-on approach of the Liechtenstein Market Authority, which is committed to further strengthening the financial services market as one of Liechtenstein's key industries, facilitate and foster an active debt market.

When it comes to market participants on the lender's site, it has to be noted that the Liechtenstein loan market is largely in the hands of international banks, as the financial sector in Liechtenstein, and in particular the Liechtenstein banks, is/are more focused on private banking and wealth management.

1.2 Impact of the Ukraine War

In line with the EU sanctions, Liechtenstein has adopted national legislation to sanction certain industries, companies and persons with close ties to or otherwise associated with the Russian Federation. In view of the fact that Liechtenstein did not host any (branches of) Russian banks and considering that neither Russia nor Ukraine are amongst Liechtenstein's main trading partners, the debt market in Liechtenstein has remained largely unaffected by the war in Ukraine.

However, the Ukraine war has had a major impact on the private wealth and asset management sector, where efforts were strengthened to combat and prevent the circumvention of EU sanctions on Liechtenstein soil.

1.3 The High-Yield Market

Liechtenstein does not have a regulated market and therefore no active high-yield market.

1.4 Alternative Credit Providers

Alternative credit providers are not regularly seen as lenders in transactions.

1.5 Banking and Finance Techniques

The Liechtenstein loan market for corporate clients is in the hands of foreign banks. The trends and therefore the documentation of financing are strongly influenced by international trends whereby the documentation of the Loan Market Association remains the "gold standard" for commercial financing in Liechtenstein.

1.6 ESG/Sustainability-Linked Lending

Liechtenstein, which ratified the Paris Agreement on climate change on 9 June 2017, has identified and declared climate risks as a core risk for the financial sector. As a member of the European Economic Area, Liechtenstein is participating in the EU-wide transformation of the financial sector towards a more long-term thinking and sustainable industry. This trend can also be found in Liechtenstein financing, where ESG-related margin grids or reporting and compliance obligations linked to environmental, social and/or governance (ESG) indicators and metrics are commonly used.

The main pillars of the remodelling process are the following EU regulations, which have been approved by the Joint EEA Committee and are therefore directly applicable in Liechtenstein.

Regulation (EU) 2019/876 (ESG Disclosure)

This regulation amends the Capital Requirement Regulation (Regulation (EU) No 575/2013) and introduces an obligation to disclose ESG risks applicable to large financial institutions that have issued securities admitted to trading on a regulated market in the European Economic Area.

Regulation (EU) 2019/2088 (Sustainability-Related Disclosures)

This regulation establishes rules as to how market participants and advisers have to integrate and consider ESG risk factors in their decision-making and investment advice processes. It also foresees additional disclosure requirements for financial advisers with a view to company-related as well as product-related information and with a special emphasis on sustainability risks and adverse effects of investment decisions in that regard.

Regulation (EU) 2019/2089 (ESG Benchmarks)

This regulation requires all providers of benchmarks or indices used to measure the performance of financial instruments or investment funds to disclose whether and how ESG factors are taken into account. It focuses on increasing transparency and uniformity when it comes to indices and also introduces two new categories of benchmarks, namely the EU climate transition benchmarks and the EU Paris-aligned benchmarks.

Regulation (EU) 2020/852 (Taxonomy)

This regulation embodies the main pillar of the EU sustainability strategy and the so-called Green Deal. It provides an investment tool and classification system – the so-called green list – that facilitates sustainable investments by identifying to what degree commercial activities can be considered environmentally sustainable. It provides for additional disclosure requirements (eg, on the alignment of financial products with the taxonomy), aims to further strengthen investor protection and to avoid so-called greenwashing.

2. Authorisation

2.1 Providing Financing to a Company

Regulatory Framework for Providing Financing

As a member of the European Economic Area, Liechtenstein has established the same regulatory framework for providing financing in Liechtenstein as other members of the European Economic Area, which is outlined below.

Liechtenstein banking license requirement

The requirement to apply for a Liechtenstein banking license not only entails the submission of very detailed and extensive documentation (eg, a business plan, envisaged organisational structure, appropriate statutes and regulations) but also requires a certain minimum corporate structure and substance in Liechtenstein. The latter requires, inter alia, a Liechtenstein entity as an applicant for the license, appropriate business premises in Liechtenstein and at least one member of the management board who must reside in or near to Liechtenstein so that he/she can reach the bank's premises within a reasonable time.

Establishing a branch in Liechtenstein

Banks from other European Economic Area Member States can establish a branch (*Zweigniederlassung*) in Liechtenstein, meaning that the bank's license obtained in the home Member State is notified or "passported" to Liechtenstein as the host Member State by the supervisory authority of the home Member State notifying the Financial Market Authority of the bank's licence.

Freedom to provide services

Banks from other European Economic Area Member States can render financing services on the basis of the freedom to provide services, meaning that no physical presence is established in Liechtenstein so that the services are rendered on a cross-border basis. This form of "passporting" also takes place via a notification to the supervisory authority in the respective home Member State, which then notifies the Liechtenstein Financial Market Authority.

Reverse solicitation

Rendering financing services on a "reverse solicitation" basis refers to transactions that were initiated and concluded on the exclusive initiative of the borrower, meaning that the bank in question did not direct its business towards clients in Liechtenstein; ie, the bank neither directly nor indirectly promoted or solicited its services to clients and/or the public in Liechtenstein. We note, however, that the concept of reverse solicitation has not been transposed into national law, which means that there is no concrete legal basis for this type of transaction. For banks, there is no published guidance from the Liechtenstein Financial Market Authority (FMA) available. Consequently, the provision of financing on the basis of reverse solicitation involves a certain degree of regulatory uncertainty and is also subject to any change on an EU/EEA level.

Financing without obtaining a banking license

Non-banks can provide financing without obtaining a banking license as long as the financing is not carried out on a commercial basis and not as the main business of the relevant lender (eg, intra-group lending).

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Subject to compliance with the regulatory requirements (see **2.1 Providing Financing to**

a Company), foreign lenders face no additional restrictions when it comes to lending to borrowers domiciled in Liechtenstein.

3.2 Restrictions on Foreign Lenders Receiving Security

There are no legal restrictions or impediments that would specifically apply to foreign lenders when receiving collateral or guarantees. For general restrictions, see **5.5 Other Restrictions**.

3.3 Restrictions and Controls on Foreign Currency Exchange

Liechtenstein law does not establish any restrictions or controls on foreign currency exchange.

3.4 Restrictions on the Borrower's Use of Proceeds

There are no specific restrictions on the borrower's use of proceeds made available under a loan or debt securities under Liechtenstein law.

However, it should be noted that certain legal entities (most importantly the company limited by shares (*Aktiengesellschaft*) and the establishment (*Anstalt*) are subject to capital maintenance rules (see **5.2 Downstream, Upstream and Cross-Stream Guarantees**) which, inter alia, limit the use of loan proceeds.

3.5 Agent and Trust Concepts

The (security) agent concept is commonly used for secured syndicated financings. Liechtenstein law – unlike most continental legal systems – also provides for a trust law that follows the Anglo-Saxon legal tradition. Consequently, the common security pooling mechanics, in particular through establishing a parallel debt (or similar) structure, are applied in Liechtenstein. However, there is no published Liechtenstein case law that has tested the (security) agent concept.

With regard to the pooling of collateral under Liechtenstein law, a distinction must be made between two different types of security: accessory (*akzessorisch*) and non-accessory (*nicht-akzessorisch*) collateral.

Accessory Collateral

Accessory collateral (most importantly, the pledge) is characterised by the existential relationship and linkage of the security to the underlying obligation secured by that security. In particular, this means that the security "follows" the secured claim (eg, if the debt is discharged, the collateral is extinguished by operation of law) and that the security taker may only hold and administer collateral if and to the extent that it is also a creditor of the secured obligation. A security pool with accessory collateral, where the security agent only holds the security interests on behalf of the other lenders, without also being a creditor of the underlying secured claims, is not permissible in Liechtenstein. This structural hurdle is often overcome by implementing a parallel debt, which consolidates the aggregate amount of debt under the financing agreements and is owed by each security provider to the security agent. On the back of this parallel debt, the security agent may hold, administer and enforce the security package on behalf of all other syndicate lenders (including the security agent itself).

Non-Accessory Collateral

Non-accessory collateral (most importantly, guarantees and security assignments/transfers) are not subject to the restrictions described above. Therefore, a security creditor can hold, administer and enforce these types of collateral regardless of who the creditor of the secured claim is.

3.6 Loan Transfer Mechanisms

A loan transfer may be achieved either through an assignment, where the lender (assignor) assigns (only) its claims against the borrower to a new lender (assignee), or via an assumption of the entire loan contract in which case all rights and obligations are transferred to the new lender. The borrower's explicit consent is required for an assumption but not for an assignment. However, until the debtor is formally notified about the change of creditor, they can redeem the loan by making payment to the original lender.

As outlined in **3.5 Agent and Trust Concepts**, an accessory collateral "follows" the respective secured obligation, meaning that if the secured claim is transferred to a new creditor, the accessory collateral is transferred to the new creditor by operation of law. Non-accessory security interests, on the other hand, have to be transferred to the new creditor requiring the debtor's consent.

A transfer of a loan, including the respective security package, can also be achieved by redemption (*Einlösung*). In this case, the new lender redeems the existing lender's claims against the borrower and requests the transfer of all associated rights (eg, security interests). The claims as well as the security interests are then transferred to the new lender by operation of law.

3.7 Debt Buy-Back

Liechtenstein law does not regulate or prohibit debt buy-backs through the borrower or a sponsor.

3.8 Public Acquisition Finance

As a member of the European Economic Area, Liechtenstein has transposed the European Takeover Directive (Directive 2004/25/EC) into national law. Certain fund rules foreseen in the Liechtenstein Takeover Act (*Übernahmegesetz*) require the bidder not only to ensure that sufficient funding is available before submitting a takeover bid, but also to disclose the terms in the bid documentation, which then has to be audited and approved by an independent auditor.

As Liechtenstein does not have a regulated market and only a limited number of listed companies, no clear Liechtenstein market standards for documentation have emerged. However, since Liechtenstein public companies are usually listed in foreign jurisdictions, the corresponding foreign rules apply to them.

3.9 Recent Legal and Commercial Developments

Following a general trend of "paperless" shares, Liechtenstein law has introduced uncertificated securities (*Werterechte*) allowing, inter alia, companies limited by shares to issue their shares in unsecuritised form. These shares must be recorded in a register (*Wertebuch*), which can also be kept as a distributed ledger within the meaning of the Liechtenstein fintech law, the Token and TT Service Provider Act (*Token- und VT-Dienstleister-Gesetz*). As disposals of such uncertificated securities are subject to different rules than disposals of certificated shares, the perfection requirements as well as the enforcement procedures had to be adopted accordingly.

3.10 Usury Laws

Liechtenstein regulatory law does not provide for any limitations when it comes to the pricing of a loan. The Liechtenstein General Civil Code (*Allgemeines bürgerliches Gesetzbuch*), on the other hand, declares agreements null and void where the value of one party's obligation is strikingly disproportionate to the value of the other party's obligation and where the beneficiary

takes advantage of the other party's carelessness, vulnerability, mental infirmity, inexperience or heightened emotional state.

The practical relevance of this rule in the context of commercial lending is very limited and more focused on retail lending where the lenders also have to comply with additional consumer protection regulations (in particular information duties).

3.11 Disclosure Requirements

Liechtenstein law does not stipulate any disclosure requirements when it comes to financing agreements.

4. Tax

4.1 Withholding Tax

Neither principal payments nor interest payments are subject to Liechtenstein withholding tax. The interest payments will have to be taken into account for income tax purposes at the lender's level.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Should a financing or the taking of a security require an increase of share capital of a company and/or the granting of shareholder contributions, capital increases and shareholder contributions can be subject to the so-called emission fee (*Emissionsabgabe*) pursuant to the Swiss Stamp Duty Act (*Bundesgesetz über die Stempelabgaben*), which also applies to Liechtenstein entities. This fee accrues in connection with the issuance and increase of the nominal value of participation rights of and the granting of shareholder contributions without consideration to, amongst others, companies limited by shares and companies with limited liability and amounts to one percent of the increased capital/contribution. The Swiss Stamp Duty Act provides for some exemptions and a general allowance for new shares amounting to CHF1,000,000.00.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

There are no tax-related concerns with regard to having foreign lenders and/or non-money centre banks from a Liechtenstein law perspective.

5. Guarantees and Security

5.1 Assets and Forms of Security

The most common security package requested by lenders for corporate borrowing consists of share pledges, bank account pledges and security assignments. In some instances, mortgages on Liechtenstein buildings/real estate are requested. In relation to the particularities and differences between accessory and non-accessory collateral, see **5.1 Assets and Forms of Security**.

Share Interests

The most common types of legal entities in Liechtenstein for corporate purposes are the company limited by shares (*Aktiengesellschaft*) and the establishment (*Anstalt*). Security interests over shares in a company limited by shares are created in the form of a pledge. The pledge is established under a share pledge agreement and perfected by carrying out certain perfection requirements (depending on if and how the shares are securitised). There are no special requirements regarding formalities that are applicable to the share pledge agreement. As to the perfection requirements, the most common form of shares, namely registered shares (*Namenaktien*), are pledged by handing over the physical share certificate to the pledgee with an endorse-

ment in blank, and registering the pledge in the share register of the company. If these steps are not taken, the pledge is not perfected.

The interests in an establishment, called "founder's rights" (*Gründerrechte*), cannot be pledged but can only be assigned for security purposes (Liechtenstein law explicitly prohibits the creation of a pledge over founder's rights). The security assignment agreement does not require any specific formalities. The security is perfected by handing over the founder's rights certificate to the pledgee and by notifying the establishment.

Bank Accounts

Security over bank accounts are typically created with pledges established under a bank account pledge agreement which is not subject to any requirements regarding formalities. The general terms and conditions of Liechtenstein account banks usually provide for a (first-rank) pledge over all assets credited or otherwise transferred to accounts held with that bank. When pledging these bank accounts, aforesaid pledges should be either waived or subordinated to the pledge of the pledgee. The pledge is then perfected by notifying the relevant account bank(s) of the pledge.

Receivables

The common security package also comprises security over receivables (in particular trade receivables and intra-group receivables). Receivables may either be pledged or assigned for security purposes. From a lender's perspective, the latter is more advantageous and thus more frequently used, as the full title to the receivables is transferred to the lender and not only a limited right in rem. The lender is, however, limited in disposing of the receivables as any disposal outside of an enforcement scenario would be a violation of the security agreement resulting in potential damage claims of the assignor. The security assignment is perfected by notifying the respective debtor of the assignment. Neither receivables pledges nor security assignments are subject to any formalities.

Movable Assets

Movable assets are also pledged under a pledge agreement that does not require any formalities. As a general principle of Liechtenstein pledge law, physical assets subject to a pledge must be handed over to and remain with the pledgee (*Faustpfandprinzip*) as a perfection requirement. Alternatively, if the assets are with a third party, the pledge may also be perfected by instructing such third party to hold the asset on behalf and for the benefit of the pledgee. It should be noted that a determinable, coherent set of assets (eg, a warehouse) can be made the subject of a pledge agreement, but the perfection requirements have to be fulfilled for every single asset of such set, meaning that the set of assets cannot be pledged as a whole. Obviously, this can have a significant impact on the practicality of pledges.

Real Estate

Security interests over real estate located in Liechtenstein is taken in the form of a mortgage (*Grundpfandverschreibung*) or mortgage certificate (*Register-Schuldbrief*). Compared to the other types of collateral, the documentation for a mortgage or mortgage certificate is strongly formalised and only the template agreement published by the Liechtenstein Office of Justice (*Amt für Justiz*) can be used. In addition, the signatures of the parties have to be notarised. The agreement is then filed and registered with the Liechtenstein Land Register (*Grundbuch*).

5.2 Floating Charges and/or Similar Security Interests

Floating charges or other universal or similar "catch-all" security interests over all present and future assets of a company are not permitted under Liechtenstein law. The assets to be charged must be clearly identified, or at least identifiable, and security cannot be created over a generic, volatile pool of assets. It should also be kept in mind that Liechtenstein law requires a perfection step for each single asset so that a security interest over an aggregation of assets (eg, a warehouse) may not be created uno actu.

5.3 Downstream, Upstream and Cross-Stream Guarantees

The most relevant and prevalent legal forms in Liechtenstein for commercial purposes (ie, the company limited by shares (*Aktiengesellschaft*) and the establishment (*Anstalt*)) are subject to capital maintenance rules which, generally speaking, prohibit a company from disbursing its assets to or for the benefit of its direct or indirect shareholder(s)/holder(s) of founder's rights, except in the case of dividend payments, share capital reductions or liquidation proceeds.

In the context of financings, this means that forwarding funds drawn under a loan as well as securing liabilities of direct or indirect shareholder(s) (up-stream) and/or affiliated entities other than subsidiaries (cross-stream) could be in breach of applicable capital maintenance rules. There are exceptions to this general rule, such as transactions carried out on an arm's length basis or where a subsidiary secures a loan granted to its shareholder which is then passed on to the subsidiary. The arm's length criterion must be assessed on a case-by-case basis and is not easy to determine as companies do not usually provide financing or security to unrelated third parties.

The legal literature is still unclear as to the consequences of a breach; ie, whether the underlying contract is only partially void or void in its entirety. In addition, the members of the board of directors are personally liable for any damages that may occur in connection with such transactions.

Given the far-reaching implications of up- and cross-stream transactions, it is advisable to have the transaction approved in advance by the general meeting of the shareholder(s)/the holder(s) of the founder's rights and the board of directors and to ensure that the statutes of the relevant company (in particular the purpose clause) permit and cover up- and cross-stream transactions. In addition, it is standard market practice in Liechtenstein to limit the potential benefit of a security by means of specific limitation language that reduces the security interest to an amount that is still in line with Liechtenstein capital maintenance rules. This can even reduce the commercial value of a security to zero in cases where no funds are available to distribute to the shareholder(s)/ holder(s) of the founder's rights of a company.

Financing and/or collateral granted on a downstream basis are not capital maintenance sensitive from the shareholder's perspective and are therefore possible without the above-mentioned limitations.

5.4 Restrictions on the Target

The same limitations and formalities outlined in 5.3 **Downstream, Upstream and Cross-Stream Guarantees** apply.

5.5 Other Restrictions

The two main limiting factors to be taken into account when granting collateral or guarantees are (depending on the type of security) the acces-

sory nature of certain collateral (and the required structural steps to properly pool those security interests – see **3.5 Agent and Trust Concepts**) and ensuring compliance with Liechtenstein capital maintenance rules (see **5.3 Downstream, Upstream and Cross-Stream Guarantees**).

In distressed scenarios, insolvency law and in particular claw-back and avoidance rights of the insolvency administrator must be taken into account. Generally speaking, an insolvency administrator can challenge legal acts (eg, the granting of security) which were performed prior to the opening of insolvency proceedings and to the disadvantage of the debtor's creditors.

For the creation and the enforcement of mortgages in Liechtenstein real estate, the restrictions of the Liechtenstein Real Estate Transfer Act (*Grundverkehrsgesetz*) must be complied with (see **6.4 A Foreign Lender's Ability to Enforce Its Rights below**).

5.6 Release of Typical Forms of Security

Collateral of an accessory nature will automatically cease to exist when the secured obligation is fully discharged (see **3.5 Agent and Trust Concepts**). It is nevertheless customary for security agreements to foresee a certain release procedure to properly document the release. The release by operation of law does not apply to non-accessory collateral (eg, security assignment and guarantees) meaning that additional steps have to be taken to accomplish the release.

The release procedures depend on the asset and the actions undertaken to perfect the security. The security interests are typically released by setting the actus contrarius; ie, by physically re-transferring the assets and documents handed over to the security agent (eg, share certificates, powers of attorney), notifying third parties (eg, account banks and third-party debtors) of the security release, deletion of register entries (eg, share register) and re-assignment of receivables and/or founder's rights to the company.

5.7 Rules Governing the Priority of Competing Security Interests

When it comes to the ranking of multiple security interests, Liechtenstein law follows the principle of priority, meaning that the security interest validly perfected first will prevail and rank ahead of any other security interest established in respect of that asset. Contractual arrangements that deviate from this principle by setting a ranking of competing security interests are valid under Liechtenstein law. It is, however, unclear whether an insolvency administration would be bound by and uphold such an agreement.

5.8 Priming Liens

The most material security interests that arise by operation of law and that rank ahead of any other (registered) security (even without registration in the Liechtenstein Land Register) are for the benefit of the state and municipalities for taxes, building insurance companies for their insurance premium claims and for claims of public undertakings (eg, land improvements) attributable to the property.

The first-ranking pledge of account banks (see **5.1 Assets and Forms of Security**), although not arising by operation of law, should also be mentioned in this context.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

As a general rule, a lender can enforce its collateral when the secured claim falls due. Security interests are either enforced in court proceedings or, if agreed by the parties, by out-of-court enforcement.

Court Proceedings

If enforced in court proceedings, the respective asset is sold in the course of a public sale in accordance with the provisions of the Liechtenstein Enforcement Act (*Exekutionsordnung*).

Out-of-court Enforcement

Depending on what has been agreed between the parties, the out-of-court enforcement can take place by public auction, private sale or a so-called self-entry, where the asset is not sold to a third party but acquired by the lender itself. Enforcement by self-entry is generally only permitted where the asset has an easily determinable market or exchange price. As a general rule, when enforcing the security interest, the lender must take into account and consider the interests of the security provider, which means that the lender must sell the asset at the best possible price.

If the asset does not have a market price, such as share interests in unlisted companies or property, independent valuations must be obtained to ensure that the asset is not sold at a below-market price. Any surplus, meaning the amount of enforcement proceeds exceeding the secured obligation, will have to be handed over to the security provider.

Liechtenstein, being a member of the European Economic Area, has also transposed the Financial Collateral Directive (Directive 2002/47/EC) into national law. If the requirements under the directive are met and if the parties agree to establish the security in the form of financial collateral, the security taker will have, inter alia, the right to appropriate the asset.

6.2 Foreign Law and Jurisdiction

Under Liechtenstein law, the law governing the agreement may be freely chosen by the parties (subject to certain limitations) as far as contractual aspects are concerned (*Vertragsstatut*). However, this does not apply to the law governing the creation, extinction and the content of rights in rem. It is therefore standard market practice that assets that are located in Liechtenstein are pledged under a Liechtenstein law-governed security agreement which then stipulates the respective perfection steps to be taken in compliance with Liechtenstein law.

The rights to immunity may be, generally speaking, waived under Liechtenstein law.

6.3 Foreign Court Judgments

Liechtenstein has neither entered into bilateral treaties nor joined multilateral treaties with other countries (except bilateral treaties with the Republic of Austria and Switzerland and a multilateral treaty limited to the subject matter of child support) regarding the mutual acknowledgement and enforcement of foreign judgments. Judgments of foreign courts (except Austrian and Swiss judgments and child support judgments) are, therefore, not enforceable in Liechtenstein without instituting summary proceedings to validate foreign judgments. However, such summary proceedings will, if persistently defended by the opposing party, not avoid a full re-litigation on the merits. As a consequence, judgments of a non-Liechtenstein, non-Swiss, and non-Austrian

court will not be directly enforceable against a company in Liechtenstein.

However, Liechtenstein is a party to the New York Convention (the Convention on the Recognition and Enforcement of Foreign Arbitral Awards), so arbitral awards from foreign arbitral tribunals are recognised and enforceable in Liechtenstein in accordance with the terms and conditions of this convention.

6.4 A Foreign Lender's Ability to Enforce Its Rights

When it comes to security interests in real estate located in Liechtenstein, according to the Liechtenstein Real Estate Transfer Act (*Grundverkehrsgesetz*), the transfer of ownership and similar rights requires a legitimate interest of the acquirer in obtaining the property. The transfer of property must also be approved in advance by the Office of Justice (*Amt für Justiz*). Without such approval, the underlying contract is null and void by law. As the declared goal of the Liechtenstein Land Transfer Act is to ensure that the land remains with the local people and businesses (which is reflected in the catalogue of legitimate interest), the market as well as the pool of potential, eligible acquirers in an enforcement scenario is limited.

In the context of regulated companies (eg, banks, investment companies, insurance companies), any intended disposal of shares in such companies (therefore also the enforcement of security interests) exceeding certain thresholds have to be notified to and approved by the Liechtenstein Financial Market Authority.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

With the commencement of insolvency proceedings, the debtor is deprived of its control over the insolvency estate, the insolvency administration takes over the day-to-day management of the company, and all outstanding obligations of such debtor become due. This means that any loan granted to such lender becomes due and payable by operation of law without the need for acceleration or termination of the loan agreement. Further, any power of attorney granted to a lender (eg, voting proxies, powers of attorney to facilitate the enforcement of collateral) will automatically lapse upon the opening of the insolvency proceedings.

In relation to assets that are subject to in rem rights of the lender, Liechtenstein insolvency law foresees a right of separation (*Absonderungsrecht*). With such a separation right, the lender is not entitled to the asset itself, but rather to preferential treatment in relation to the proceeds from the sale of that asset. The asset is sold by the insolvency administration and the proceeds are handed over to the lender up to the amount of his secured claim. Any excess amount is returned to the insolvency estate. This applies to in rem rights where the full title is transferred to the lender (eg, security assignments) as well as collateral granting a limited in rem right (eg, pledges).

Rights in personam (eg, guarantees, sureties and other joint liabilities) are not "insolvency-proof" and do not benefit from any preferential treatment, meaning that creditors with security in personam rank pari passu with the other unsecured creditors of such debtor.

Liechtenstein law also provides for a claw-back and avoidance regime, under which the insolvency administrator may set aside certain legal acts detrimental to the insolvency estate and to the interests of the debtor's creditors that were performed within a certain period prior to the opening of the insolvency proceedings.

7.2 Waterfall of Payments

The Liechtenstein Insolvency Act (*Insolvenzordnung*) provides for a mandatory waterfall of claims as follows:

- claims of segregation (*Aussonderungsansprüche,* eg, assets in the insolvency estate that are owned by third parties) and claims of separation (*Absonderungsansprüche* eg, creditors that are secured by a pledge or security assignment);
- estate claims (*Masseforderung*), such as the costs of the insolvency proceedings itself and contractual arrangement made by the insolvency administrator; and
- claims of unsecured creditors.

7.3 Length of Insolvency Process and Recoveries

The length of the proceedings depends largely on the complexity of the company's business and the number of creditors, and can range from one to several years. Insolvency proceedings in Liechtenstein often involve creditors from several different jurisdictions, which further slows down the proceedings. The full value of the company is seldom fully recovered during insolvency. However, there have been instances where the recovery quota has exceeded 50 percent of the owed amounts.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Liechtenstein reformed its Insolvency law in 2021 to provide a regime more focused on the survival and restructuring of a company rather than its liquidation. The Liechtenstein Insolvency Act (*Insolvenzordnung*) distinguishes between two types of proceedings, namely insolvency proceedings (*Konkursverfahren*) aiming at the liquidation of the company's assets and restructuring proceedings (*Sanierungsverfahren*) focusing on the continuation of the company. The latter has two sub-variants, namely restructuring proceedings with self-administration (*Sanierungsverfahren mit Eigenverwaltung*) and restructuring proceedings without self-administration (*Sanierungsverfahren ohne Eigenverwaltung*).

Restructuring Proceedings With Self-Administration

Restructuring proceedings where the debtor retains control of the company, therefore with self-administration, can only be opened and approved where the debtor itself has filed for insolvency. This sub-variant of restructuring proceedings is not available to the debtor if insolvency proceedings have already been opened. In addition to the insolvency petition, the debtor has to submit a restructuring plan (*Sanierungsplan*). In the restructuring plan, the debtor has to offer to its creditors a minimum quota of 20 percent to be paid within the next two years. The restructuring plan must then be accepted by the creditors with a double majority; ie, the majority of the votes of the creditors present at the court hearing and these creditors must represent more than 50 percent of the total amount of the insolvency claims of the creditors present at the hearing. Provided that the debtor complies with the terms of the restructuring plan and meets its payment obligations in full, the residual debt is discharged. If the debtor fails to comply with

its duties under the restructuring plan, regular insolvency proceedings are opened.

Restructuring Proceedings Without Self-Administration

In proceedings without self-administration, the debtor is deprived of its control over the company and the insolvency court appoints a restructuring administration to manage the company's affairs. Unlike restructuring proceedings with self-administration, restructuring proceedings without self-administration may also be commenced after insolvency proceedings have already been opened. The debtor has then to submit a restructuring plan offering its creditors a minimum quota of 20 percent to be paid within the next two years. The restructuring plan is put to the vote of the insolvency creditors, which have to approve the plan with a double majority (regarding restructuring with self-administration, see above). If the debtor complies with the terms of the restructuring plan and discharges its payment obligations thereunder in full, the residual debt is discharged. If it fails to comply with its duties under the restructuring plan, regular insolvency proceedings are opened.

7.5 Risk Areas for Lenders

The Liechtenstein Insolvency Act (*Insolvenzordnung*) in conjunction with the Liechtenstein Legal Protection Act (*Rechtssicherungs-Ordnung*) provide for a claw-back and avoidance regime under which an insolvency administrator may challenge certain legal acts taken within a certain period of time prior to the opening of the insolvency proceedings. This includes certain disposals:

- for no consideration or only inadequate consideration, made within one year prior to the opening of insolvency proceedings;
- made at a time the debtor was already illiquid within one year prior to the commencement of insolvency proceedings; and
- made with the purpose of disadvantaging the other creditors of the debtor, regardless of when this act has been taken.

8. Project Finance

8.1 Recent Project Finance Activity

Infrastructure projects in sectors like transportation, energy, water supply and public health do not play a significant role in Liechtenstein due to its size. Furthermore, the state maintains a major stake in this infrastructure.

8.2 Public-Private Partnership Transactions

Liechtenstein law does not provide for a separate legal framework for project financing and/or public-private partnerships. Where public procurement is involved, the parties will have to comply with the Liechtenstein Public Procurement Act (*Gesetz über das Öffentliche Auftragswesen*). Liechtenstein is also a party to the Agreement on Government Procurement of the WTO, which applies in particular to construction services.

8.3 Governing Law

Liechtenstein does not provide for a specific legal framework for project financing, so there is no legal requirement when it comes to the choice of law.

8.4 Foreign Ownership

See **8.1 Recent Project Finance Activity**.

8.5 Structuring Deals

See **8.1 Recent Project Finance Activity**.

8.6 Common Financing Sources and Typical Structures

See 8.1 Recent Project Finance Activity.

8.7 Natural Resources

See 8.1 Recent Project Finance Activity.

8.8 Environmental, Health and Safety Laws

See 8.1 Recent Project Finance Activity.

LUXEMBOURG

Law and Practice

Contributed by:
Andreas Heinzmann, Hawa Mahamoud and Christoforos Naziroglou
GSK Stockmann SA

Contents

GSK Stockmann SA is a leading independent European corporate law firm with over 250 professionals across our offices in Germany, Luxembourg and the UK. GSK Stockmann is the law firm of choice for real estate and financial services. In addition, the firm has deep-rooted expertise in key sectors including funds, capital markets, public, mobility, energy and healthcare. For international transactions and projects, GSK Stockmann works together with selected reputable law firms abroad. In Luxembourg, GSK Stockmann is the trusted adviser of leading financial institutions, asset managers, private equity houses, insurance companies, corporates and fintech companies, with both a local and international reach. The firm's lawyers advise domestic and international clients in relation to banking and finance, capital markets, corporate/M&A and private equity, investment funds, real estate, regulatory and insurance as well as tax.

Authors

Andreas Heinzmann is a partner in the banking and capital markets group of GSK Stockmann in Luxembourg and specialises in securities law, capital markets regulation and international banking work. He advises banks, financial institutions and corporates on the issue of debt and equity securities, including stock exchange listings, securitisations, repackagings, high-yield bonds, structured products and derivatives, and publishes regularly in these fields of expertise. Andreas is a member of working groups on securitisation organised by bodies of the financial industry in Luxembourg.

Hawa Mahamoud is a senior associate in the banking and capital markets group of GSK Stockmann in Luxembourg and specialises in banking law, securities law, capital markets regulation and corporate laws. She advises banks, financial institutions and corporates on the issue of debt and equity securities, including stock exchange listings, securitisations, repackagings, high-yield bonds, structured products and derivatives, and related regulatory matters.

Christoforos Naziroglou is an associate in the banking and capital markets group of GSK Stockmann in Luxembourg and specialises in banking law, securities law, capital markets regulation and corporate laws. He advises banks, financial institutions and corporates as well as insurance companies on the issue of debt and equity securities including stock exchange listings, securitisations, repackagings, high-yield bonds, structured products and derivatives and related regulatory matters.

GSK Stockmann SA

44 Avenue John F. Kennedy
L-1855
Luxembourg

Tel: +352 271802 00
Fax: +352 271802 11
Email: luxembourg@gsk-lux.com
Web: www.gsk-lux.com

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Luxembourg's economy has been strong and steadily expanding over recent years. Prior to 2020, the real economy was booming and the business and credit cycle was moving upwards. The COVID-19 health crisis only temporarily impacted the real economy, which contracted in 2020 by -1.3% – significantly less than the EU average of -5.9%. In 2021, real GDP bounced back strongly to +5.1%. The loose monetary policy implemented by the ECB and the accumulation of wealth during the previous years led to a buoyant economic situation, which made capital markets and banking institutions more accessible to financial participants and consequently facilitated the realisation of investments in the real economy. As a result, the Luxembourg debt market grew significantly during 2021.

The political and economic developments of 2023 slowed the expansion of the global and Luxembourg debt market. The interest rate rises implemented by the ECB in response to the unprecedented high inflation within the Eurozone, together with ongoing geopolitical uncertainty, have adversely affected investments due to higher borrowing costs. According to market data provided by the ECB on 28 August 2023, the Eurozone money supply has shrunk for the first time since 2010 as private sector lending stalls and deposits decline. Nevertheless, time and again Luxembourg has proved its resilience and adaptability to unexpectedly adverse developments. Despite the recent adverse economic developments, in 2022 GDP growth in Luxembourg was 1.5% year-on-year, and GDP is projected to grow by 1.1% in 2023, compared to projected Euro area GDP growth of slightly below 1.0%.

Luxembourg remains a major international financial centre, with a booming asset management industry (with a total of EUR5.1 trillion of assets under management as of May 2023) and a sound banking system, with 120 authorised banks operating in Luxembourg (as of August 2023). Luxembourg's financial centre continues to attract financial institutions and investors from across the world.

1.2 Impact of the Ukraine War

Luxembourg professionals of the financial sector, which is subject to the supervision of the Commission de Surveillance du Secteur Financier (CSSF), have been obliged to implement and comply with the financial restrictive measures adopted by the European Union in response to Russia's invasion of Ukraine. Accordingly, Luxembourg has reportedly frozen EUR5.5 billion of Russian assets (as of December 2022), including bank accounts and transferable securities. As a result, Luxembourg banks have been reducing their exposure to Russia and Ukraine in an attempt to limit the impact of the decline in the market valuation of their assets. In addition, in the realm of debt capital markets, issuers have amended the terms of issue documentation to account for the potential risks arising from geopolitical instability in the markets where they operate. These adjustments are designed to refine the assessment of market risks linked to securities, given the uncertain regional macroeconomic conditions.

At the same time, the geopolitical instability seems to have exerted only a marginal influence on Luxembourg's loan market. According to market data for Q1 2023, debt securities and loans of non-financial corporations and the private non-financial sector have remained relatively stable since Q1 2022 and have increased since Q1 2021. Similarly, as of Q1 2023, debt

securities issued by resident financial corporations have also remained stable.

1.3 The High-Yield Market

The Luxembourg Stock Exchange (LuxSE) is the leading European listing venue for high-yield bonds. Together with the European High Yield Association, LuxSE published in 2006 the first EU guidance and rules on listing high-yield bonds, allowing corporate issuers with complex ownership structures access to capital markets. LuxSE now accounts for approximately 50% of the listed high-yield bond market in Europe. A large number of such high-yield bonds are listed and admitted to trading on the multilateral trading facility (Euro MTF) operated by LuXSE. Being outside the scope of (i) the Prospectus Regulation (EU) 2017/1129 and (ii) the transparency requirements set forth in Directive 2004/109/EC, the Euro MTF is not a regulated market and, hence, offers a lighter listing and disclosure framework to issuers.

High-yield bonds are regularly issued by corporate entities for financing, refinancing and general corporate purposes.

Although the majority of high-yield bonds listed on the LuxSE are governed by foreign laws, market players are now more frequently choosing Luxembourg law to govern high-yield bond issue documentation. Furthermore, thanks to a stable and reliable legal framework, Luxembourg vehicles are often used for the issue of high-yield bonds.

Furthermore, large European institutions like the European Investment Bank (EIB), the European Investment Fund (EIF) and the European Stability Mechanism (ESM) have opted for Luxembourg law as the governing law of their instruments. The EIB chose Luxembourg law to govern its digital bond, whereas guarantees provided by the EIF are typically governed by Luxembourg Law. Additionally, since October 2020, the European Stability Mechanism chose Luxembourg law as the governing law for the issue of its euro-denominated bonds. This trend is viewed as a significant endorsement of the Luxembourg legal framework and is likely to reassure a wide range of issuers, including supranational debt issuers, who frequently use LuxSE as a listing venue for sovereign bonds. It encourages a shift away from foreign jurisdictions towards Luxembourg law for the issue of debt instruments admitted to trading and/or listed on LuXSE.

1.4 Alternative Credit Providers

The granting of loans is, in principle, a regulated activity, the performance of which requires the holding of a licence from the CSSF, as further detailed in **2.1 Providing Financing to a Company**.

Despite the above, the Luxembourg loan market, as the main domicile for non-bank financial institutions in Europe and thanks to a booming alternative finance industry, continues to see strong growth in alternative credit providers (such as securitisation vehicles and regulated or alternative investment funds) benefiting from exemptions to licensing requirements (see **2.1 Providing Financing to a Company** for the scope of exemptions).

1.5 Banking and Finance Techniques

See **5.4 Restrictions on Target** on the recent change of the Law of 10 August 1915 on companies, as amended (the "Companies Law") following the adoption of draft bill No 7791.

1.6 ESG/Sustainability-Linked Lending

In line with the growing global demand for sustainable finance following the COP 21 agreement

and the ratification of the UN Sustainable Development Goals, sustainable finance has gained a significant role in the Luxembourg financial sector, which is a leading international hub for sustainable finance.

The world's first legal framework for green covered bonds was established in Luxembourg in 2018 and is expected to play a pivotal role in promoting the funding of ESG-compliant projects.

Initiatives taken at the level of the European Union, such as the EU Action Plan on Sustainable Finance, have created a certain number of regulatory standards for professionals in the finance industry (notably, the ESG disclosure requirements deriving from Regulation (EU) 2019/2088 and Regulation (EU) 2020/852), applying also to Luxembourg market players.

The following is an overview of the most recent changes affecting the banking regulatory architecture in Luxembourg.

Regulation (EU) 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial services sector (the SFDR), laying down harmonised rules for financial market participants and financial advisers on transparency with regard to the integration of sustainability risks and the consideration of adverse sustainability impacts in their processes and the provision of sustainability-related information with respect to financial products, applies to, among others, credit institutions providing portfolio management. While market participants were required to comply with most of the sustainability-related disclosures laid down in the SFDR as from 10 March 2021, as from 1 January 2022, credit institutions providing portfolio management have to comply with the provisions of the SFDR, relating to the production of periodic reports, including the transparency of the promotion of environmental or social characteristics and of sustainable investments.

Regulation (EU) 2020/852 of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (the Taxonomy Regulation) applies to, among others, credit institutions providing portfolio management. It aims to provide transparency to investors and businesses and to prevent "greenwashing" by defining and harmonising at the EU level the criteria following which a financial product or an economic activity could qualify as "environmentally sustainable".

Following the requirements introduced by the Taxonomy Regulation, financial market participants that make financial products available should disclose how and to what extent they use the criteria for environmentally sustainable economic activities to determine the environmental sustainability of their investments. Such disclosure applies as follows:

- as from 1 January 2022, concerning the environmental objectives of climate change mitigation and climate change adaptation; and
- as from 1 January 2023, concerning other environmental objectives.

Additionally, another important initiative at the EU level is the proposal for a regulation of the European Parliament and of the Council on European green bonds (the "Green Bond Regulation"). The Green Bond Regulation, according to the current content of the proposal, will lay the foundation for a common framework of rules regarding the use of the designation "European green bond" or "EuGB" for bonds that pursue environmentally sustainable objectives within the meaning of the

Taxonomy Regulation. It will also set up a system for registering and supervising companies that act as external reviewers for green bonds aligned with this framework. It will facilitate further developing the market for high-quality green bonds, thereby contributing to the Capital Markets Union, while minimising disruption to existing green bond markets and reducing the risk of greenwashing. On 28 February 2023, a political agreement was reached between the European Parliament and the Council on the proposal of the Green Bond Regulation.

With regard to local initiatives, the Luxembourg government, in co-operation with the private sector, founded in 2020 the Luxembourg Sustainable Finance Initiative (LSFI). Its main aspirations are to promote existing and upcoming sustainable finance initiatives, to co-ordinate and support the Luxembourg financial centre in taking impactful actions in the field of sustainable finance and to measure the progress that is made in this sector to integrate sustainability by collecting and analysing data on the Luxembourg financial industry. Through this initiative, the Luxembourg government has sent yet another strong signal of the country's determination to help mainstream sustainable finance.

Furthermore, Luxembourg was the first European country to launch a sustainability bond framework in September 2020. This framework, which meets the highest market standards, was the first in the world to fully comply with the new recommendations of the European taxonomy for green financing. Following the establishment of the sustainability bond framework, Luxembourg has successfully issued its first sovereign sustainability bond, for an amount of EUR1.5 billion, with a 12-year maturity and bearing a negative interest rate of -0.123%. The bonds have been listed on the Luxembourg Green Exchange, the world's first dedicated and leading platform for green, social and sustainable securities, which was launched in 2016. The Luxembourg Green Exchange has the largest market share of listed green bonds worldwide.

2. Authorisation

2.1 Providing Financing to a Company

According to the Luxembourg law of 5 April 1993 on the financial sector, as amended (the "LFS"), any person granting loans in Luxembourg on a professional basis must hold a licence of a credit institution or a professional in the financial sector carrying on lending activities.

Pursuant to Article 28-4 of the LFS, professionals granting loans to the public for their own account (ie, credit institutions) and professionals of the financial sector performing lending operations (such as financial leasing and factoring operations) fall under the scope of the licence requirements.

The granting of loans could be an activity exempted from licensing requirements, in so far as, among others, loans are not granted to the public.

Entities looking to engage in lending activities in Luxembourg need to satisfy a number of legal requirements as set out in the LFS.

Since November 2014, the ECB has been exclusively competent for the authorisation and qualifying holding approvals of all credit institutions (except for branches of a third-country-based entity), while the authorisation of non-bank entities as well as branches of a third-country-based entity seeking to provide loans in Luxembourg remains within the remit of the CSSF.

Furthermore, the CSSF closely monitors lending activities given that such activities continue to develop outside traditional banking circuits. As such, lenders looking to engage in lending activities in Luxembourg should approach the CSSF by submitting a detailed description of the envisaged activities and obtain clearance from the CSSF.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

As indicated in **2.1 Providing Financing to a Company**, the granting of loans is, in principle, a regulated activity in Luxembourg that should be provided by duly licensed credit institutions or non-bank entities.

Lenders based within the European Union can grant loans in Luxembourg through the provision of cross-border services, the establishment of a branch or the appointment of a tied agent, provided that they hold an authorisation from the ECB or the competent authority of their home member state, as the case may be, to perform lending activities.

Lenders based in a third country can only grant loans in Luxembourg through the establishment of a branch. Such branch shall be subject to the same authorisation rules as those applying to credit institutions and other professionals governed by the LFS. Furthermore, third country-based lenders wishing to grant loans without having an establishment in Luxembourg but that occasionally and temporarily come to Luxembourg in order to, among others, collect deposits and other repayable funds from the public and provide any other regulated service under the LFS, are also subject to prior authorisation from the CSSF. However, the CSSF clarified in its Q&A that going to Luxembourg temporarily to carry out an upstream or downstream activity from the above-mentioned activities is not subject to authorisation.

3.2 Restrictions on Foreign Lenders Receiving Security

See **3.1 Restrictions on Foreign Lenders Granting Loans** on restrictions on foreign lenders granting loans. Provided that the foreign lender lawfully grants loans in Luxembourg, there are no specific restrictions relating to the granting of security to secure such loan, to the extent that the security is constituted on a type of asset over which security can be granted.

3.3 Restrictions and Controls on Foreign Currency Exchange

CSSF Circular No 12-538 on lending in foreign currency, implementing the recommendation of the European Systemic Risk Board of 21 September 2011 on lending in foreign currencies (ESRB/2011/1), provides for specific conditions to be observed by credit institutions and professionals performing lending activities when providing loans in a foreign currency. The provisions of the Circular aim, among others, to enforce the risk awareness of borrowers in a foreign currency, highlight the creditworthiness of the borrowers as a condition to be analysed by credit institutions and indicate to credit institutions the need for incorporating into their internal risk management systems the specific risks entailed in foreign currency lending.

3.4 Restrictions on the Borrower's Use of Proceeds

Unless otherwise agreed between the borrower and lender, and save for the financing of criminal activities, there are no specific restrictions

related to the use of proceeds arising out of a loan or debt instruments.

3.5 Agent and Trust Concepts

The concepts of agent and agency (*mandat*) are governed by the Luxembourg Civil Code.

The Securitisation Law provides for a specific legal framework applying to agents in charge of representing investors' interests. It expressly allows the granting of security interests and guarantees to a (security) agent without the need to use parallel debt provisions in the relevant documentation. The rights and obligations of such agent should be assessed on the basis of the Civil Code provisions governing the agency.

Furthermore, under the Law of 27 July 2003 on trusts and fiduciary agreements, as amended (the "Fiduciary Law"), foreign trusts are recognised in Luxembourg to the extent that they are authorised by the law of the jurisdiction in which they are created.

According to the Fiduciary Law, a Luxembourg fiduciary may enter into a fiduciary agreement with a fiduciary, pursuant to which the fiduciary becomes the owner of a certain pool of assets forming the fiduciary estate, which are, even in an insolvency scenario, segregated from the assets of the fiduciary and held off balance sheet.

3.6 Loan Transfer Mechanisms

Under Luxembourg law, loans (receivables) can be transferred by the lender through an assignment, subrogation or novation.

Assignment of Receivables

All rights and obligations on the receivables may be assigned by a lender to an assignee pursuant to Articles 1689 et seq of the Luxembourg Civil Code. The assignee will therefore become the legal owner of the receivables so transferred. Such transfer of the receivable should then be notified to the debtor in accordance with Article 1690 of the Luxembourg Civil Code.

Subrogation

Pursuant to Articles 1249 et seq of the Luxembourg Civil Code, receivables may also be transferred by way of contractual subrogation; ie, a third party will pay to the original lender the amount owed by the debtor and will then be subrogated to all rights and actions the original creditor could have exercised against the debtor prior to the payment by the third party.

Novation

Also, pursuant to Articles 1271 et seq of the Luxembourg Civil Code, receivables may be transferred by way of novation; ie, all parties must consent that a new lender will substitute the original lender and assume its obligations under a new agreement made between the new lender and the debtor.

However, pursuant to Article 1278 of the Luxembourg Civil Code, any security interests (such as privileges or mortgages) attached to a former (extinct) claim lapse by virtue of the novation unless the lender has explicitly reserved them to subsist. In addition, following the general rule provided by Article 1692 of the Luxembourg Civil Code, which applies to accessory security in Luxembourg, the transfer or assignment of receivables includes the transfer of its accessory rights, including any security interests (such as privileges or mortgages).

3.7 Debt Buy-Back

Should the instrument being bought back be a debt instrument listed on a European Union regulated market or a multilateral trading facility, the

provisions of, respectively, Regulation (EU) No 596/2014 on market abuse (ie, an assessment should be made on whether such buy-back would constitute price-sensitive information that is likely to be considered as inside information) and rules of the relevant securities exchange on which such debt instrument is listed (if any, such as ensuring equal treatment among bondholders as far as the rights attaching to debt securities held by the latter are concerned) should be observed.

The issuer of instruments may also elect to initiate a tender offer addressed to the holders of instruments offering to purchase back all or part of its outstanding debt under specific conditions. Such tender offer is documented in a tender offer memorandum which sets out the terms and conditions of the tender offer and which delineates the period of time for investors to respond. In the case of an issuer of debt instruments admitted to trading on a regulated market who has chosen Luxembourg as its home member state, the provisions of the Law of 11 January 2008 on transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (the "Transparency Law") will be applicable with respect to the manner of communicating the terms of the tender offer to investors.

Save for the above and unless otherwise contractually agreed between the parties, there are no restrictions applicable to debt buy-backs in Luxembourg.

3.8 Public Acquisition Finance

The Luxembourg legal framework as regards public finance transactions derives from the provisions of the Law of 19 May 2006 on takeover bids, as amended (the "Takeover Bids Law"), transposing Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 (the "Takeover Bids Directive").

The CSSF is the competent authority for supervising takeover bids, provided that the offeree has its registered office in Luxembourg and its securities are publicly traded on a regulated market in Luxembourg.

The procedure to observe while making a public takeover bid derives from the rules set forth in the Takeover Bids Directive and is rather standard throughout the European Union. In a nutshell, the offeror must inform the CSSF of its intention to make a public takeover bid, before disclosing such decision to the public. Subsequently, the offeror must draw up and make public an offer document that will provide information on the takeover offer to the holders of the target company. Such document shall also be communicated to the CSSF for approval within ten working days from the day on which the bid was made public.

3.9 Recent Legal and Commercial Developments

Blockchain III Law

The Luxembourg law of 15 March 2023 implementing Regulation (EU) 2022/858 of 30 May 2022 on a pilot scheme for market infrastructures based on distributed ledger technology (the "DLT Pilot Regime") was published in the Luxembourg official journal (*Mémorial A*) on 17 March 2023 (the "Blockchain III Law"). The Law's main goals are to explicitly acknowledge distributed ledger technology (DLT) in the financial industry and to provide financial market participants with complete legal certainty so they may fully capitalise on the potential presented by this new technology. The Blockchain III Law amends several laws relating to the financial sector.

The FSL was amended to clarify that the definition of "financial instrument" also includes financial instruments issued by means of DLT as defined in article 2(1) of the DLT Pilot Regime. Following the amendments introduced by the Blockchain III Law, the Collateral Law (as defined below) clarifies that under its scope fall pledges on securities accounts maintained within or through secured electronic registration mechanisms, including distributed ledgers or electronic databases. It is now confirmed that the validity and perfection of a collateral created under the Collateral Law will not be affected by the technical means by which the pledged security is created or held.

The provisions of this law complete and complement the provisions of the Luxembourg law of 1 March 2019 and of the law of 22 January 2021 which created a legal framework explicitly recognising the possibility of using distributed ledger technology for the issuance and circulation of securities as well as the custody of book-entry financial instruments.

Administrative Dissolution without Liquidation

The law of 28 October 2022 introducing a new procedure of administrative dissolution without liquidation was published on 4 November 2022 and entered into force on 1 February 2023. The commercial entities covered by this law are those that have no assets and no workers and fall under the scope of Article 1200-1(1) of the Companies Law. Such companies will be subject to an administrative dissolution procedure without liquidation. The procedure will be initiated by the state prosecutor but undertaken by the administrator of the Luxembourg Trade and Companies Register. The law is a response to the need to deal with the large number of businesses in Luxembourg that are operating illegally, have no assets or employees, and whose judicial liquidations or bankruptcy proceedings are a significant time and financial burden on the judicial system.

Reorganisation Proceedings

On 19 July 2023, the Luxembourg parliament passed a new law to modernise insolvency law and preserve businesses (the "Reorganisation Law"), in view of the provisions of the Directive (EU) 2019/1023 of the European Parliament and of the Council, of 20 June 2019, on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt.

The three main points of the law relate to (i) conciliation (conservatory measure); (ii) judicial reorganisation proceedings; and (iii) reorganisation by mutual agreement (out-of-court procedure).

Conciliation

In order to simplify the reorganisation of all or a portion of its assets or business, the debtor requests that the Minister for the Economy or the Minister for Small and Medium-Sized Enterprises appoint a conciliator (*conciliateur d'entreprise*).

Judicial reorganisation proceedings

Depending on the intended outcome, the Law provides for three alternative court reorganisation proceedings:

Mutual agreement

The debtor wants to reach a mutual agreement and is planning to do so by obtaining a stay (*sursis*). In contrast to the aforementioned reorganisation by mutual consent (out-of-court procedure), the proceeding is judicial, making the common rules listed below relevant.

Collective agreement

The debtor wants to come to a collective agreement (*accord collectif*) on a reorganisation plan with certain of its creditors. The Reorganisation Procedures Directive also includes a provision for the UK's cross-class cram-down mechanism, which the Law incorporates into this process. This makes it possible for a restructuring plan to, in some cases, bind creditor classes that are not in agreement.

Transfer by court order

One or more third parties receive a court order transferring all or a portion of the debtor's assets or business. Employees and employee representatives are involved in this proceeding, which may be voluntary.

Reorganisation by mutual agreement

Reorganisation by mutual agreement (*accord amiable*) is a consensual out-of-court process wherein the debtor and at least two of its creditors concur to reorganise all or a portion of the debtor's assets or business. The mutual agreement is enforceable and payments made in accordance with it are enforceable against the insolvent estate even if they occur during the suspect period once it has been approved by the District Court (*tribunal d'arrondissement*).

The new law will enter into force on 1 November 2023.

3.10 Usury Laws

In principle, the interest rate may be freely determined between the parties to a loan agreement and may exceed the legal interest rate. However, if the interest rate is manifestly usury, a Luxembourg court may reduce it to the applicable legal interest rate. In accordance with the Civil Code, interest charged on a loan can be usurious if it is clearly disproportionate to the market interest rate, and the weakness, predicament or inexperience of a borrower is exploited. In addition, if the borrower is a consumer, information must be provided regarding the effective annual global interest rate (*taux annuel effectif global*) and on the interest amount charged for each instalment of the loan.

3.11 Disclosure Requirements

Save for specific rules imposed by the LFS on group financial support agreements, which regulate the provision of financial support from one party to another in the event that at least one of the parties to the agreement fulfils the conditions for early intervention, there is generally no obligation to disclosure financial contracts in Luxembourg.

Issuers of financial instruments offered to the public, and/or admitted to trading to a regulated market, being subject to the Prospectus Regulation, are obliged to disclose material contracts. More specifically, the Prospectus Regulation requires that a brief summary of all material contracts that are not entered into in the ordinary course of the issuer's business, which could result in any group member being under an obligation or an entitlement that is material to the issuer's ability to meet its obligations to security holders in respect of the securities being issued, should be included in the body of the prospectus.

4. Tax

4.1 Withholding Tax

Subject to the Law of 23 December 2005 (the "Relibi Law"), as a matter of principle, there is no withholding tax in Luxembourg on payments of principal, interest or other sums made by a borrower to a lender (unless such payment of

principal and interest are not at arm's length). As a consequence, payment obligations of borrowers to lenders would be made free of any withholding tax.

However, as per the Relibi Law, payments of interest or similar income made, or ascribed, by a paying agent established in Luxembourg to, or for the benefit of, a Luxembourg resident individual lender will be subject to a withholding tax of 20%.

If the individual lender acts in the course of the management of their private wealth, the aforementioned 20% withholding tax will operate a full discharge of income tax due on such payments.

4.2 Other Taxes, Duties, Charges or Tax Considerations

No other taxes, duties, charges or tax considerations are imposed on lenders while making or transferring loans to, or taking security or guarantees from, debtors based in Luxembourg, save that the registration of the loan/security/guarantee documentation will be required where such documentation is physically attached to a public deed or to any other document subject to a mandatory registration in Luxembourg. Furthermore, should the taking of security imply the transfer of rights on immovable property located in Luxembourg or aircraft or boats registered in Luxembourg, such transfers would be subject to an ad valorem registration duty.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

There are no particular tax concerns with regard to foreign lenders and non-money centre banks. We refer in this regard to the answers provided in **4.1 Withholding Tax** and **4.2 Other Taxes, Duties, Charges or Tax Considerations**. However, under specific conditions, interest payments made to lenders established in jurisdictions included on the EU list of non-cooperative jurisdictions for tax purposes are not deductible in Luxembourg.

5. Guarantees and Security

5.1 Assets and Forms of Security

Under Luxembourg law, credit support can take various forms, from the most traditional forms of contractual undertakings pertaining to civil contract law to a highly lender-friendly financial collateral regime.

Security Governed by the Collateral Law

The Law of 5 August 2005 on financial collateral arrangements, as amended (the "Collateral Law"), provides for various techniques to grant security in guarantee for financial debts; namely, pledges, transfers of title for security purposes (including by way of fiduciary transfer) and repurchase agreements. The collateral under these arrangements can take the form of any "financial instruments and claims". A variety of assets may consequently be used as financial collateral. Typical collateral will take the form of shares of a company, bonds, intercompany receivables, bank accounts and securities accounts, without prejudice to more peculiar sorts of collateral such as insurance receivables and the capital calls and commitments of the investors in a fund.

The Collateral Law clarifies that under its scope fall pledges on financial instruments which are in physical form, dematerialised, transferable by book entry, including the securities accounts maintained within or through secured electronic registration mechanisms, including distributed ledgers or electronic databases, or delivery, bearer or registered, endorseable or not and

regardless of their governing law. The reference to tokenised financial instruments is a recent addition to the provisions of the Collateral Law, made pursuant to the Luxembourg law of 15 March 2023, and confirms that the validity and perfection of a collateral created under the Collateral Law will not be affected by the technical means by which the pledged security is created or held.

Security Governed by the Civil Code and Special Laws

The in rem securities under civil law may also be granted, such as commercial pledges, inventory pledges and mortgages over real estate properties. Other types of securities – such as (i) mortgages over aircraft, governed by the law of 29 March 1978, and (ii) a general pledge over ongoing business concerns, governed by the Grand Ducal decree of 27 May 1937, as amended (the "1937 GDD") – are also available under Luxembourg law.

The Civil Code provides an entire regime for suretyships (*cautionnements*), but also recognises the enforceability of other personal securities, such as autonomous guarantees, comfort letters and other sui generis personal undertakings.

In addition, the Law of 17 July 2020 on professional payment guarantee (the "PPG Law") introduced a new form of flexible professional payment guarantee, which may be adapted to the specific transaction, with the provisions agreed by the parties receiving full recognition under Luxembourg law, without risk of recharacterisation.

More specifically, the PPG Law introduced a new legal form of guarantee, going beyond the traditional distinction between suretyship and first-demand guarantee, whereby the former constitutes an accessory obligation, the existence and enforceability of which depends on the status of the underlying guaranteed obligation and the latter creates an obligation to the guarantor that is independent from the underlying secured obligation. The PPG Law introduces an optional (opt-in) contractual guarantee regime that allows the parties to structure their contract by combining features of the existing guarantee types, without them facing the risk of recharacterisation. More specifically, unless otherwise agreed by the parties, the professional payment guarantee can be enforced irrespective of the default of the underlying obligation. In that sense, the guarantor cannot raise any defence related to the underlying obligation to the creditor. On top of that, the insolvency of the debtor or the commencement of a reorganisation plan will not affect the obligations of the guarantor. At the same time, unless otherwise agreed, the guarantor will be subrogated to the rights and obligations of the creditor, after the repayment of the guarantee.

Finally, under the PPG Law, it is possible to grant a guarantee in favour of an intermediary that acts for the benefit of the creditor. The application of the PPG Law requires that the guarantor provides guarantees on a professional basis, that the parties explicitly opt in to the PPG Law and that the agreement is evidenced in writing.

Formalities and Perfection Requirements for a Security Governed by the Collateral Law

Pledges over financial instruments and claims require that the pledgor must be dispossessed with respect to the pledged assets, which is typically achieved as follows:

- through a pledge over (i) the shares of a private limited liability company, by the mere conclusion of the pledge agreement between

the pledgor and the pledgee in the presence of the company that issued the pledged shares and its registration in the shareholders' register of the said company, and (ii) the shares of a public limited liability company following its registration in the shareholders' register of the company that issued the pledged shares;
- in view of the general rights of (first-ranking) pledge, lien, set-off or retention banks usually have (pursuant to their general terms and conditions) on bank accounts, a pledge over a bank account is perfected upon its notification and acceptance by the bank with which the pledged bank account is maintained; the relevant bank usually signs an acknowledgement of the pledge, which is standard to contain a waiver of its aforementioned general rights of pledge, lien, set-off or retention over the relevant bank account; and
- through a pledge over receivables, upon the mere conclusion of the pledge agreement; however, the debtor of the pledged receivables will be discharged while making payments to the pledgor unless it has been notified of the existence of the pledge over the receivables to the benefit of the pledgee.

With respect to a transfer of title by way of security, the pledgee transfers the ownership in relation to the financial instruments and/or receivables to the beneficiary until the secured obligations have been discharged, triggering the obligation of the beneficiary to retransfer the financial instruments and/or receivables to the pledgor. The transfer of title by way of security will be perfected against the debtor and third parties upon its execution by the pledgor and the beneficiary. However, the debtor of the transferred receivables will be discharged while making payments to the pledgor unless the debtor has been notified of the existence of the transfer of title over the receivables to the benefit of the pledgee.

Security Governed by the Civil Code and Other Special Laws

The creation of a security right over immovable property or aircraft requires the realisation of a number of formal requirements. The security right can be created only through a notarial deed, which has to be registered with the tax administration and relevant publicly held mortgage register. Meeting those formalities is costly and might take time.

Equally formal and expensive is the creation of a security right over ongoing business concerns, which has to be witnessed in a written contract and registered in a mortgage registry. The collateral will comprise all the tangible and intangible assets of a business as well as half of its outstanding shares.

Guarantees

Guarantees and suretyships are perfected by the mere conclusion of the relevant agreement creating such security.

5.2 Floating Charges and/or Similar Security Interests

The creation of a floating charge interest over the assets of a company is not possible under Luxembourg law, pursuant to the Luxembourg law principle of prohibition to secure future or after-acquire assets. The Luxembourg law concept that is closest to a floating charge is the pledge over ongoing business concerns referred to in **5.1 Assets and Forms of Security**.

In addition, the Collateral Law provides for the possibility to create securities over all financial instruments of a pledgor, even those that will be acquired and/or issued in the future. Hence, it

is common that borrowers grant to their lenders a security package comprising pledges on certain financial instruments and claims held by such borrowers and governed by the Collateral Law. The perfection of pledges will depend on the type of the collateral, as described in **5.1 Assets and Forms of Security**.

Furthermore, under Luxembourg law, security interests with respect to future assets are, in principle, considered a promise to pledge (*promesse de gage*), to deliver the future assets and to create in the future the security interest as long as the assets are not in possession of the pledgee of the third-party holder. As an exception to the Luxembourg law principle of prohibiting the securing of future or after-acquire assets, it is possible to agree (by way of contract) to pledge future or after-acquired assets once they have entered into the ownership of the pledgor and are transferred into the possession of the pledgee or a third-party holder pursuant to a pledge agreement.

5.3 Downstream, Upstream and Cross-Stream Guarantees

As a general rule, all transactions of a company (including the provision of guarantees or security) must comply with the company's corporate object as set forth in its articles of association and be in the interest of the company. The latter concept means that a company may not engage in transactions that, though lawful, are aimed at conferring exclusive or substantially exclusive benefits on a person other than the company itself.

This condition is generally met in the event that a company provides collateral to secure its own indebtedness. It is also clearly fulfilled in all instances where a company gives collateral to secure the indebtedness of third parties or other group companies in exchange for an arm's length consideration.

The above condition is also met if the company is providing an exclusive downstream guarantee since one would assume that such a guarantee is helpful for the subsidiary of the relevant company to obtain credit and that will enhance the business of the subsidiary, which, in turn, will result in an increased value of the shareholding of its parent company.

Finally, the condition is also met if the guarantor derives an indirect benefit such as the possibility to borrow, under favourable conditions from the bank taking the relevant security, or in cases where the secured loan (or part thereof) is on-lent by the other group company to the company providing the collateral. Guarantees to secure loans to other group companies or to the parent also meet the "corporate interest" condition if these guarantees are necessary for the continuing operations of the relevant company and if the guarantor heavily depends on those operations.

Upstream and Cross-Stream Guarantees

There is no Luxembourg legislation governing group companies that specifically regulates the organisation and liability of groups of companies. As a consequence, the concept of group interest as opposed to the interest of the individual corporate entity is not expressly recognised in Luxembourg. As such, a company may not encumber its assets or provide guarantees in favour of group companies in general (at least as far as parent companies and subsidiaries of its parent companies are concerned) unless the said Luxembourg company assists other group companies.

In practice, upstream or cross-stream guarantees are limited to a certain percentage of the guarantors' net assets.

If a court finds that financial assistance such as the giving of a guarantee is not showing a sufficient benefit to the company, its managers may be held liable for action taken in that context. Furthermore, under certain circumstances, the managers of the latter company may incur criminal penalties based on the concept of misappropriation of corporate assets (Article 1500-1 of the Luxembourg Companies Law). Ultimately, it cannot be excluded that if the relevant transaction were to be considered as misappropriation by a Luxembourg court or if it could be evidenced that the other parties to the transactions were aware of the fact that the transaction was not for the company's corporate benefit, the transaction might be declared void based on the concept of illegal cause (*cause illicite*).

5.4 Restrictions on the Target

As a general rule, companies that are an acquisition target are prohibited from financing the buyout of their shares. However, it is possible for a public limited liability company, under certain conditions as provided for in the Companies Law, to directly or indirectly advance funds, grant loans or provide guarantees or security with a view to the acquisition of its own shares by a third party. If the requirements of the Companies Law are not met, the directors of the company may face civil or criminal liability.

The question of whether criminal sanctions provided under Article 1500-7 paragraph 2° of the Companies Law apply to managers of a private limited liability company or not, has been controversial until recently, mainly due to the use of the term "corporate units" in the said article. This controversy has been clarified with the entry into force of the law of 16 August 2021, which amended the provision of Article 1500-7 paragraph 2° of the Companies Law. The Companies Law makes no reference to the term "corporate units" and hence criminal sanctions provided under the said article do not apply to managers of a private limited liability company. Financial assistance is therefore not prohibited for private limited liability companies.

5.5 Other Restrictions

There are no material restrictions save for those described in **5.2 Floating Charges and/or Similar Security Interests** (notification formalities required for the perfection of pledges over receivables, bank accounts and the shares of a private limited liability company) and **5.3 Downstream, Upstream and Cross-Stream Guarantees**.

5.6 Release of Typical Forms of Security

A security, whether a pledge or a mortgage, is released once the secured obligation is fully discharged (Articles 2082 and 2180 of the Civil Code) or as provided for in the security agreement. Despite such explicit provisions of the Civil Code and for the sake of good order, the parties of a security agreement usually sign a release agreement, which asserts that either the secured obligations under the security arrangement have been paid in full and that the collateral is to be released or the security taker consents to release the pledgor from its obligations under the collateral.

5.7 Rules Governing the Priority of Competing Security Interests

As a general principle, contractually secured creditors enjoy a privilege over the assets of the debtor that is restricted on the encumbered asset.

With respect to a security interest created pursuant to the Collateral Law, unless otherwise agreed, the first priority pledgee is entitled to receive any proceeds arising out of the enforcement of the security interest.

As regards a security interest (which creates a right in rem), the priority of pledges is determined by the date on which they became enforceable against third parties; ie, on a first-to-file basis in the relevant register (eg, mortgage register, register of shareholders).

In practice, priority rules of competing creditors are usually contractually adapted through entering into an intercreditor agreement; for instance, between creditors that should provide and govern the subordination among creditors as per their respective rights over the security interest. Hence, in the case of enforcement of the security interest, lower-ranked creditors will be subordinated in rank, priority and enforcement to upper-ranked creditors, subject to the provisions of the intercreditor agreement, if any.

Even though there are no general Luxembourg law provisions on contractual subordination, there is evidence of limited Luxembourg case law supporting the validity of special subordination clauses against the bankruptcy receiver of an insolvent borrower.

5.8 Priming Liens

Generally, under Luxembourg law, there are no security interests arising by operation of law. However, there are legal provisions that recognise specific preferences to a group of creditors, effectively making them senior to other creditors of the obligor. Following the insolvency of a Luxembourg company, certain creditors benefit from preferences arising by operation of law, which may supersede the rights of secured creditors. These are notably the salaried employees of an insolvent company, the Luxembourg tax authorities and the Luxembourg social security institutions.

Another example can be found in the Civil Code, which provides that the subrogee who partially paid the debt of a third party will be entitled to exercise its subrogation right against the original debtor only after the debt of the principal creditor has been entirely satisfied. The application of this provision leads to a de facto subordination of the subrogee.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

A typical loan security package in Luxembourg includes security interests governed by the Collateral Law and guarantees, the enforcement of which could be made as follows.

Security Governed by the Collateral Law

The pledgee can, upon the occurrence of the contractual trigger event (which may be a default under the secured obligations – see also **5.1 Assets and Forms of Security**) and without prior notice, inter alia:

- appropriate the security or have it appropriated by a third party at market price (if any) unless otherwise agreed;
- sell or cause the security to be sold in a private transaction under arm's length conditions, by a public sale or by way of an auction;
- request a court that title to the security be transferred to it as payment of the secured obligations;

- appropriate the security at its market price if traded on a trading venue defined in the Collateral Law as a regulated market, multilateral trading system, or organised trading facility system; or
- otherwise enforce the security in any other manner permitted by Luxembourg laws, including, if applicable, by requesting a set-off or direct payment.

The last amendment of the Collateral Law introduced an alternative method of enforcement with respect to the appropriation of units or shares of a collective investment undertaking, whereby a pledgee can redeem them at the redemption indicated in the instruments of incorporation of this undertaking.

Another amendment included in the Law relates to the public auction procedure for the enforcement of pledges, which can now be carried out by a notary or bailiff, designated as auctioneer by the creditor. The Collateral Law now also delineates the auction procedure, the designation of the pledged assets to be sold, the methods of publication and the deadlines.

Enforcement of Guarantees

Due to the independent nature of a guarantee, the calling of it could be made as contractually agreed between the parties (even in the absence of a default or the occurrence of the risk guaranteed). However, certain contractually agreed conditions might be observed by the beneficiary before proceeding to the calling of a guarantee.

6.2 Foreign Law and Jurisdiction

Under Luxembourg laws, parties to an agreement can freely choose the law governing such agreement and submission to a foreign jurisdiction, subject to such choice not being abusive. Hence, the choice of foreign law as the governing law of the contract will – in accordance with, and subject to, the provisions of Regulation (EC) No 593/2008 of 17 June 2008 on the law applicable to contractual obligations – be recognised and upheld by Luxembourg courts, unless the chosen foreign law was not made bona fide and/or if:

- the foreign law was not pleaded and proved; or
- if pleaded and proved, such foreign law would be contrary to the mandatory rules of Luxembourg law or manifestly incompatible with Luxembourg international public policy.

The submission by the parties to the jurisdiction of foreign courts would be upheld by the Luxembourg courts, with the exceptions provided for in **6.3 Foreign Court Judgments**.

6.3 Foreign Court Judgments

Judgment Given by a Foreign Court

A final and conclusive judgment rendered by the following courts would be enforced by Luxembourg courts without a retrial or re-examination of the matters thereby adjudicated, save for the examination of the compliance of such judgment with Luxembourg public order:

- European Union-located courts, in accordance with applicable enforcement proceedings as provided for in Regulation (EU) No 1215/2012 (the "Brussels Regulation"); and
- European Free Trade Association (EFTA)-located courts, in accordance with applicable enforcement proceedings as provided for in the Lugano convention of 30 October 2007 (the "Lugano Convention").

A final and conclusive judgment rendered by the below-mentioned courts would be enforced by Luxembourg courts as follows:

- England and Wales courts subject to (i) the provisions of the Convention of 30 June 2005 on choice of court agreements (the "Hague Convention"), (ii) the exequatur procedure as set out in Article 678 of the Luxembourg New Civil Procedure Code and (iii) established Luxembourg case law in respect of the enforcement of foreign law judgments; and
- a non-EU- or non-EFTA-located court, subject to (i) the applicable exequatur procedure as set out in Article 678 of the Luxembourg New Civil Procedure Code and (ii) established Luxembourg case law in respect of the enforcement of foreign law judgments.

Arbitral Award

An arbitral award may be enforced in Luxembourg provided that all the requirements of the enforcement procedure set out in Articles 1250 and 1251 of the Luxembourg New Civil Procedure Code have been satisfied.

6.4 A Foreign Lender's Ability to Enforce Its Rights

Other than those mentioned in **6.1 Enforcement of Collateral by Secured Lenders** to **6.3 Foreign Court Judgments**, there are no other matters that might impact a foreign lender's ability to enforce its rights under a loan or security agreement in Luxembourg.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

The declaration of a Luxembourg company as insolvent results in the implementation of a moratorium/automatic stay that prevents all unsecured creditors of the insolvent company from taking any enforcement actions against the company's assets. In that sense, common creditors are obliged to wait for the completion of the procedure and the allocation of the assets on a pari passu basis.

On the other hand, secured creditors and especially those benefiting from a security governed by the Collateral Law are exempted from the automatic stay (safe harbour) and, hence, can enforce their rights upon the occurrence of a trigger event (as contractually agreed between the parties), irrespective of any insolvency proceeding being initiated at the level of the collateral grantor.

Bankruptcy remoteness is an essential feature of the Collateral Law that further extends such insolvency safe harbour to financial collateral arrangements governed by laws other than those of Luxembourg, provided that the security provider is established in Luxembourg. To benefit from this additional safe harbour, the foreign-law-governed security agreements should be "similar" to the Collateral Law, with a similar scope of financial instruments and/or claims within the meaning of the Collateral Law.

The insolvency of the borrower does not have any impact on guarantees issued by third parties.

7.2 Waterfall of Payments

The order of priority payments on a company's insolvency is, pursuant to the Civil Code, as follows:

- creditors of the bankrupt estate (including the court's and bankruptcy administrator's costs and fees);
- preferred creditors;
- ordinary unsecured creditors; and
- shareholders, who are treated as subordinated creditors and receive any surplus from

the liquidation, if any, in proportion to their shareholding.

If the company's assets are not sufficient to pay the preferred creditors with a general preferential right, the claims of these creditors take precedence over the other creditors (including creditors with a special preferential right or with a mortgage).

Creditors benefiting from a security governed by the Collateral Law are out of the scope of the above-listed order, as further explained in **5.1 Assets and Forms of Security**.

7.3 Length of Insolvency Process and Recoveries

There is no statutory determination of the maximum duration of insolvency proceedings under Luxembourg law. They typically last between one and three years and in complex cases or where litigation is involved, they may last much longer.

With respect to the recovery rate of insolvency proceedings, it should be noted that in many cases the insolvent companies are holding companies or SPVs. In view of that, the recovery rate is typically rather high, especially with respect to SPVs, unless the value of the underlying assets has deteriorated. Additionally, most lenders, being institutional investors, are provided with collateral governed by the Collateral law, which is carved out from the insolvency proceedings.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Under Luxembourg law, the following types of reorganisation procedures outside of insolvency proceedings are available for a company, provided that its centre of main interests for the purpose of Regulation (EU) 2015/848 (the "Insolvency Regulation") and central administration are located in Luxembourg.

Controlled Management

A company can apply for the regime of controlled management in the event that it loses its commercial creditworthiness or ceases to be in a position to fulfil its obligations, in order (i) to restructure its business or (ii) to realise its assets in good condition. An application for controlled management can only be made by the company itself. It requires that the company has not been declared bankrupt by the Luxembourg courts and is acting in good faith. Controlled management proceedings are rarely used as they are not often successful and generally lead to bankruptcy proceedings.

Preventative Composition Proceedings

A company may enter into preventative composition proceedings in order to resolve its financial difficulties by entering into an agreement with its creditors, the purpose of which is to avoid bankruptcy.

Preventative composition proceedings may only be applied for by a company that is in financial difficulty. Similar to controlled management proceedings, preventative composition proceedings are not available if the company has already been declared bankrupt by the Commercial District Court or if the company is acting in bad faith. The application for the preventative composition proceedings can only be made by the company and must be supported by proposals of preventative composition.

Reprieve from Payment Proceedings

A reprieve from payments of a commercial company can only be applied to a company that, because of extraordinary and unforeseeable events, has to temporarily cease its payments

but that has, on the basis of its balance sheet, sufficient assets to pay all amounts due to its creditors. The reprieve from payments may also be granted if, despite the applicant currently operating at a loss, there are compelling indicators suggesting a likely return to a balanced financial state between its assets and debts.

The purpose of the reprieve from payments proceedings is to allow a business experiencing financial difficulties to suspend its payments for a limited time after a complex proceeding involving both the Commercial District Court and the Cour supérieure de justice and the approval by a majority of the creditors representing, by their claims, three-quarters of the company's debts (excluding claims secured by privilege, mortgage or pledge).

The suspension of payments is, however, not for general application. It only applies to those liabilities that have been assumed by the debtor prior to obtaining the suspension of payment and has no effect as far as taxes and other public charges or secured claims (by right of privilege, a mortgage or a pledge) are concerned.

The above procedures will be in place in Luxembourg until the Reorganisation Law enters into force in Luxembourg on 1 November 2023. See **3.9 Recent Legal and Commercial Developments**.

7.5 Risk Areas for Lenders

A lender might incur certain risks related to the recovery of its rights against a security provider or a guarantor in the process of insolvency. The transaction with the security provider or guarantor in the process of insolvencymay be challenged by the appointed insolvency administrator. A conjectural cancellation could have one of the following legal consequences. If the transaction with the lender took place during the pre-bankruptcy suspect period (which is a period of six months and ten days preceding the opening of insolvency proceedings against the given security provider/guarantor), the court could, in theory, invalidate the transaction, if it is proved that the transaction took place while the parties were aware of the coming insolvency of the debtor. It is also possible that a creditor of the debtor might file an actio pauliana to challenge transactions that took place prior to the insolvency, irrespective of the suspect period, if the creditor can prove that it incurred damage, associated with the reduction of the estate of the insolvent debtor, and that the transaction took place in bad faith and deliberately to damage the creditor.

The above-mentioned risks do not affect security rights obtained under the provisions of the Collateral Law.

8. Project Finance

8.1 Recent Project Finance Activity

Project finance could be described as a technique for the design, financing, construction, management and exploitation of large infrastructure projects involving a promoter that sponsors and implements the financed project. The given project is typically financed through a legally and financially standalone project company (a special-purpose vehicle) with the promoter(s) being a strategic partner.

Generally speaking, there is no specific legal framework governing project finance in Luxembourg. A financing may, however, be subject to a specific legal regime depending on the industry to which a given financed project would belong. Despite the foregoing, the European Invest-

ment Bank (EIB) – being the largest multilateral financial institution in the world and one of the largest providers of project finance, and having its headquarters in Luxembourg – and, more recently, the largest Chinese banks that set up their European hubs in Luxembourg, mainly focus on private sector and vital infrastructure development around the world, with a solid track record of financing a variety of (infrastructure) projects focused on climate and the environment, development, innovation and skills, small and medium-sized businesses, infrastructure and cohesion.

8.2 Public-Private Partnership Transactions

The concept of public-private partnership (PPP) commonly refers to the use of private finance for infrastructure procurement and public service provision. Save for rules deriving from, among others, the Law of 8 April 2018 on public procurement, as amended, the Law of 3 July 2018 on concession contracts, building permits, environmental and health laws that should be taken into account in PPP transactions, there are neither specific rules nor restrictions applicable to PPPs in Luxembourg.

8.3 Governing Law

There is no statutory obligation which requires project documents to be governed by Luxembourg law. Thus, the parties are free to choose English or New York law as their governing law.

Nevertheless, Luxembourg law has become more and more popular among financial participants. See also **1.3 The High-Yield Market**.

8.4 Foreign Ownership

In principle, under Luxembourg law, there are no restrictions on the ability of foreign entities to have ownership rights on the surface and soil. It is also clear that such foreign companies can also have a lien thereon. It should, however, be noted that the legal title to natural resources is always held by the state. In this respect, should an entity discover the existence of natural resources it shall request a concession permit from the Luxembourg state.

8.5 Structuring Deals

The main issues that should be considered when structuring a deal would strongly depend on the nature of and potential risks associated with the financed project and the involved parties.

8.6 Common Financing Sources and Typical Structures

In Luxembourg, notwithstanding the particularities of the financed project, typical financing sources are through (i) credit facilities provided by credit institutions or alternative credit providers or (ii) the issuance of debt instruments to be placed with investors.

8.7 Natural Resources

There are no specific restrictions on exporting natural resources; however, environmental, health and safety laws could impose burdens on the parties to a transaction.

8.8 Environmental, Health and Safety Laws

Legal provisions concerning environmental, health and safety issues are codified in the Luxembourg Environmental Code. Those fields are supervised by, respectively, the Ministry of the Environment, Climate and Sustainable Development (with respect to Environment-related matters) and the Ministry of Health (with respect to health and safety-related matters).

Trends and Developments

Contributed by:
Arnaud Arrecgros, David De Pasquale, Maurice Honnen and Despoina Souroviki
Maples and Calder (Luxembourg) SARL

Maples and Calder (Luxembourg) SARL operates as the independent law firm of the Maples Group in Luxembourg, providing full-service advice on Luxembourg law with regard to corporate, finance, funds and investment management, tax and associated regulatory matters. Clients include leading corporations, banks and structured finance arrangers, as well as hedge funds, private equity firms and asset managers. The finance team, comprised of six lawyers, advises and represents both borrowers (including private equity and hedge funds) and lenders on cross-border financing and banking transactions, including corporate debt facilities, acquisition, asset and real estate financing and restructurings, funds financing in connection with the setting up of bridge and capital commitment facilities, and securitisations, as well as on capital markets matters.

Authors

Arnaud Arrecgros is head of Maples and Calder (Luxembourg)'s Finance team at the Maples Group. He has extensive experience in cross-border financing and banking transactions, including corporate debt facilities, acquisition, asset and real estate financing and restructurings, funds financing in connection with the setting up of bridge and capital commitment facilities, securitisations, as well as capital markets matters. He represents both borrowers (including private equity and hedge funds) and lenders on lending transactions and all types of secured transactions, advising in particular on the setting up of security packages and issues surrounding collateral in the context of debt restructuring transactions.

David De Pasquale is of counsel in Maples and Calder (Luxembourg)'s Finance team at the Maples Group. His practice involves advising institutional lenders and borrowers (corporations, private equity groups and investment funds clients) on cross-border financing transactions. David also advises clients on securitisation and capital markets transactions.

Contributed by: Arnaud Arrecgros, David De Pasquale, Maurice Honnen and Despoina Souroviki,
Maples and Calder (Luxembourg) SARL

Maurice Honnen is an associate of Maples and Calder (Luxembourg)'s Finance team at the Maples Group. He advises on various types of cross-border financing and banking transactions, as well as on securitisations and capital markets matters.

Despoina Souroviki is an associate of Maples and Calder's Luxembourg Office in the Finance team. Despoina's expertise covers banking and financial law with a focus on international financial law including securitisations, international bond issues, syndicated loan agreements and derivatives. She advises on various types of cross-border financing and banking transactions. She also has experience in EU supervisory law and in particular authorisations, withdrawals, qualifying holdings, own funds, passporting and "fit and proper" assessments, as well as matters related to the interpretation of the SSM Regulation.

Maples and Calder (Luxembourg) SARL

12E, rue Guillaume Kroll
L-1882
Luxembourg

Tel: +352 28 55 12 00
Fax: +352 28 55 12 01
Email: onlineenquiry@maples.com
Web: www.maples.com

Contributed by: Arnaud Arrecgros, David De Pasquale, Maurice Honnen and Despoina Souroviki,
Maples and Calder (Luxembourg) SARL

Current Perspectives

Despite the complicated business environment seen over the past year, the Luxembourg banking and finance field of practice remained very active for the most part, fuelled by innovative market trends and new entrants.

Fund finance

Following some turmoil in the banking industry during the first half of the year, the market demonstrated strong levels of activity across the third and fourth quarters, with material increases in volumes, including over the summer period. The fund finance market has been marked by (i) a diversification in the lenders' pool and (ii) a technical diversification in the financing arrangements that are being implemented.

On the technical side, alongside new subscription line facilities being set up, together with the ancillary accessions and extensions, there has been, in line with market anticipation, a growing number of hybrid and tailor-made financing arrangements, co-investment lines and a surge in net asset value credit facilities ("NAV facilities").

The significant increase in NAV facilities derives from various factors; primarily, these factors are linked to the current business environment. The increase in prices has, to begin with, led some managers to question the cost of subscription lines. In addition, the less favourable fundraising conditions have caused fund-raises to last for longer periods. Finally, challenging market conditions have often discouraged the sale of assets and required follow-on investments, including after the exhaustion of subscription lines, leaving managers in need of new types of financing arrangement that accommodate longer investment period strategies.

However, beyond the constraints caused by the market, the managers have become increasingly familiar with NAV facility arrangements over the past few years, and they are now more comfortable making use of these as a tool to aid them in implementing their portfolio management and investment strategies.

There has also been a diversification in the lenders' pool, with new participants such as regional banks, debt funds and insurance companies increasing their market share in the field. The liquidity squeeze that has affected the traditional credit institutions since the winter of 2022, which resulted from a multiplicity of factors (capital constraints, regulatory environment and material increase in interest rates, to name a few), is one of the major causes for such diversification, forcing managers to seek capital from new types of lenders (other than traditional banks and credit institutions). It is likely that these new players will help satisfy the liquidity demand for the foreseeable future.

This trend is also encouraged by managers' appetite for establishing relationships across a fund group with several different lending entities, so as to address concentration concerns pertaining to the failure of a number of US banks during the first quarter of the year, for the sake of greater agility in case similar scenarios occur in the future.

The foregoing context has led to more attention being paid to particular provisions of the finance documents in the course of their negotiation.

As an example, lenders are now typically more reluctant to limit their ability to direct payment of unfunded commitments to bank accounts other than the pledged collateral accounts that are opened in the name of the fund. This would

allow the lenders to direct the funding of these amounts to any other account in the case of an enforcement scenario and in instances where the account bank or depositary is financially vulnerable.

Borrowers also tend to look closely at the conditions subject to which the collateral account may be transferred to a succeeding account bank or depositary, making sure these are not unreasonably or unnecessarily constrained.

The market is therefore adapting to conditions where the prospect of a bank's failure seem possible. In addition there has, over the past year, been a lot of scrutiny on related concerns by market players, and on the legal framework applicable to credit institutions in such circumstances. Since the failure of Silicon Valley Bank in early 2023, the finance industry expressed concerns in particular with respect to the options available to the parties when the account bank fails.

The banking union

In order to anticipate the possible consequences that could detrimentally affect their interests in the case of a failure of an account bank in Luxembourg, many market participants on the lender side expressed concerns at the relevant time. In this context, the second and third pillars of the banking union become relevant.

The banking union was created in 2014 as part of the EU's response to the global financial crisis. Consisting of three pillars (banking supervision, banking resolution and the deposit guarantee scheme (DGS)), its aim was to protect the stability of the financial system. Banking supervision aims at preventing a failure whilst the goal of banking resolution and DGS is to minimise the impact of a failure on the financial system by ensuring depositors' protection and that critical functions continue to operate.

The key element to determine the possible failure of a bank is the failing or likely to fail assessment (FOLTF), which is performed by the European Central Bank (ECB) in collaboration with the Single Resolution Board (SRB). There are four requirements for a bank to be declared as FOLTF:

- it no longer fulfils the requirements for authorisation by the supervisory authority;
- it has more liabilities than assets;
- it is unable to pay its debts as they fall due; and
- it requires extraordinary financial public support.

Once the bank is declared as FOLTF, the resolution authority determines whether the FOLTF bank meets the resolution requirements and whether it will be resolved pursuant to the provisions of the Banking Resolution and Recovery Directive (BRRD) or be liquidated in accordance with the national insolvency law. The key factor for determining whether the BRRD resolution process is to be followed is whether there is public interest in avoiding the liquidation of the FOLTF bank. There can be no doubt that the public interest requirement would be met for most of the banks acting as account banks in Luxembourg. The BRRD currently includes four resolution tools: the bail-in tool, the sale of business tool, the bridge institution tool and the asset separation tool.

As a reminder, it is important to note that in July 2022, the Luxembourg law of 5 August 2005 on financial collateral arrangements was amended. Among the changes implemented to modernise the law, an express reference to the Regulation

(EU) 2021/23 of 16 December 2020 on a framework for the recovery and resolution of central counterparties (commonly referred to as the Recovery and Resolution Regulation) was added in Article 2-1, so that the Financial Collateral Law is stated to apply without prejudice to such regulation.

However, under the current legal framework, deposits up to EUR100,000 are protected under the DGS. In a bank failure scenario where deposits are determined unavailable, depositors shall have access to their funds within seven working days from such determination in Luxembourg. The deposits of limited partnerships would normally be covered by the DSG. This is not the case though for SICAVs (including limited partnerships), SOPARFIs or SPFs which are currently excluded from the DGS.

In April 2023, the Commission, having assessed the results of the first years of the banking union, adopted a legislative proposal to reform the crisis management and deposit insurance framework. One of the major improvements of the reform is that funds held by non-bank financial institutions including e-money institutions, payment institutions and investment firms will now be protected.

Securitisation

European Commission takes legal action against Luxembourg over exemption for securitisation vehicles from interest limitation rules

When Luxembourg implemented the first EU Anti-Tax Avoidance Directive (ATAD I), it exempted EU-regulated securitisation vehicles. Put simply, ATAD I denies entities the deduction of interest expenses in excess of their interest income. This exemption aimed at safeguarding the tax neutrality of certain securitisation vehicles. In particular, entities that receive non-interest income, such as securitisation vehicles holding portfolios of non-performing loans, relied on this exemption.

In 2020, the EU Commission issued a letter of formal notice to Luxembourg, requesting it to amend its laws in order to remove this exemption. The Commission considered the exemption to be an infringement of EU law. Although the Luxembourg government quite swiftly submitted a bill to parliament proposing to remove this exemption, the parliament never approved this bill. The Commission therefore decided to bring the case before the European Court of Justice.

Whatever the outcome of this dispute may be, market players have in many instances been able to manage the risk linked to the EU interest limitation rules. The Luxembourg Capital Markets Association (LuxCMA), for instance, issued an interpretation according to which capital gains from non-performing loans may be booked as interest income equivalent for tax purposes up to a certain threshold. Although not binding upon the Luxembourg tax authorities, the LuxCMA's positions reflect market practice and are well respected. Additional support recently came from the Irish Revenue, which updated its guidance on the Irish interest limitation rules (which derive from the same directive) in line with the LuxCMA's interpretation.

Luxembourg trust structures emerge as a new trend for securitisations

Luxembourg trust structures (*fiducies* in French) have occasionally been promoted as an alternative to the well-known *société à responsibilté limitée* (private limited liability company) to mitigate the risks deriving from the EU interest limitation rules. As a rule, trusts are not subject to

Luxembourg taxation but are taxed at the level of the economic beneficiary.

There has been a notable recent trend towards using Luxembourg trust structures in legal practice. A search with the Luxembourg Trade and Companies Registry seems to confirm this trend: the vast majority of the currently 71 Luxembourg securitisation funds, which are dedicated securitisation vehicles without legal personality, are set up in the form of Luxembourg trusts (the remainder being co-ownership structures). Twenty-two of those special trust structures were formed in 2022 and 2023 (data cut-off date: 31 August 2023).

These figures do not take into account the numerous Luxembourg trust vehicles employed in securitisations which are not reflected in the Luxembourg Trade and Companies Registry's statistics because they have not opted into the special rules for securitisation funds.

Initially, Luxembourg trust structures were not widely accepted by foreign investors – not least because some Luxembourg market participants were reluctant to present the *fiducie* as essentially equivalent to the Anglo-Saxon trust. This is not surprising since Luxembourg is a jurisdiction with a civil law tradition with a concept of property that has evolved separately from that of common law jurisdictions.

However, the reluctance to call the *fiducie* a trust may be seen as unjustified for two reasons. First, etymologically, the Latin origin of the word *fiducie*, fiducia, literally translates to trust. The legal framework applicable to Luxembourg trusts is designed to meet all of the requirements that would allow the *fiducie* to qualify as a trust within the meaning of the Hague Convention on the Law Applicable to Trusts and their Recognition. This is particularly important as it makes Luxembourg a jurisdiction that recognises the institution of the trust for the purposes of Article 13 of the Hague Convention, which strengthens the recognition by contracting states of foreign law-governed trusts whose significant elements point to Luxembourg.

Ironically, it appears that the same civil law legacy that originally caused uncertainty with regard to the *fiducie* concept in common law jurisdictions is precisely one of the reasons for its growing popularity, as corresponding concepts sometimes exists in the foreign jurisdictions where market participants to deals being implemented these days are located (for instance, the *fideicomisco* in Mexico).

The most important characteristic of the Luxembourg trust is that the assets held in trust form a segregated estate that is separate from the trustees' personal estate, and are hence protected against claims of the trustees' personal creditors, even after the opening of insolvency proceedings. Conversely, the recourse of creditors whose claims arose in connection with the trust are limited to the trust property only.

Given that Luxembourg is a civil law jurisdiction, it would have been inconceivable to simply replicate the equitable principles of Anglo-Saxon trust law into Luxembourg statutory law to govern the relationship between the parties. Likewise, it would have been impracticable to design an entirely new set of rules. For this reason, the Luxembourg legislature decided to apply the rules applicable to mandates to the relationship between the settlor and the trustee. This provides for the highest degree of legal certainty as it allows legal practitioners to resort to an abundance of case law and legal doctrine that has developed over two centuries in all jurisdictions

applying the Napoleonic civil code. Importantly, these rules impose a fiduciary duty on the trustee towards the settlor, called *devoir de loyauté* (literally "duty of loyalty").

This duty, however, does not extend automatically to the beneficiaries that are not parties to the trust agreement. Their rights need be expressly stipulated and will be enforced in accordance with the well-established rules on third-party rights (*stipulation pour autrui*). The parties otherwise have ultimate freedom to contractually determine their rights and obligations in the trust instrument.

Although the beneficiaries formally have only a personal claim against the trustee, the legal mechanics of the trust are such that effectively the rights of the beneficiaries display more similarities with proprietary rights (*doits réels*). For instance, the law on Luxembourg trusts expressly provides that a conveyance of trust property in violation of the terms of the trust cannot be held against the beneficiaries if the purchaser had notice thereof. The beneficiaries may, in such case, seize the trust assets in the hands of the purchaser. Parallels with the laws of following and tracing in Anglo-Saxon trusts law can therefore be drawn.

Despite the general flexibility of Luxembourg trusts, certain restrictions apply. Under Luxembourg law, trusts can only be established expressly, requiring a written agreement between the settlor and the trustee. Also, the capacity to act as a trustee is reserved to a defined number of financial entities, most of which are regulated (securitisation trusts, however, do not necessarily need to be licensed). Since 2020, the parties to a Luxembourg trust need to be disclosed to the Luxembourg authorities for anti-money laundering purposes.

With respect to securitisations in particular, it should be noted that there are two ways in which a securitisation trust may be structured. The first is to set up the securitisation trust in the form of a securitisation fund mentioned above. Such trusts may avail of the features of the Luxembourg securitisation framework, most prominently the possibility to compartmentalise multiple transactions within the same structure. The other is a common trust, which is not subject to the securitisation law. Compartmentalisation is not possible within those structures; however, administrative formalities are reduced as these trusts are not required to be registered with the Luxembourg Trade and Companies Registry. Their constituent document does not need to be published, which is helpful in transactions where confidentiality is important.

MACAU SAR, CHINA

Law and Practice

Contributed by:
Frederico Rato, Pedro Cortés and Calvin Tinlop Chui
Rato, Ling, Lei & Cortés – Advogados | **Lektou**

Contents

Rato, Ling, Lei & Cortés – Advogados | Lektou is a Macau SAR-based law firm with more than 35 years' experience of legal practice in Macau. Services regularly provided by the firm include issuing legal opinions and advising on Macau law, helping international companies to start their businesses in Macau and assisting in the reorganisation of economic groups with connections to Macau. In 2016, Rato, Ling, Lei & Cortés partnered with Zhong Yin Law Firm, in the People's Republic of China, and Fongs, in Hong Kong, to open a new office on Hengqin Island, Zhuhai, PRC: ZLF Law Firm. This is the first law office that unites firms from the two Special Administrative Regions and Mainland China. The firm has also recently opened an office in Lisbon. The academic and professional backgrounds, specialisations and experience of the lawyers of Rato, Ling, Lei & Cortés are key to the assistance given to the firm's worldwide clients.

Authors

Frederico Rato is a senior partner at Rato, Ling, Lei & Cortés who practises in the areas of corporate, commercial and corporate, energy, real estate, banking and finance, gaming, intellectual property and labour law. He is a member of the Macau Lawyers Association, the Portuguese Bar Association and the Justice Department of Guangdong.

Pedro Cortés is managing partner of Lektou, where he began his career as a lawyer in 2003, with experience in gaming, corporate and M&A, capital markets, and banking and finance. He is admitted to practice in Macau, Portugal, Brazil (São Paulo), China (as a cross-border Macau lawyer) and East Timor. He is a member of the International Association of Gaming Advisors (IAGA), the Hong Kong Institute of Directors (HKIoD), the International Bar Association (IBA), the Chartered Institute of Arbitrators (CIArb) and the Hong Kong Institute of Arbitrators (HKIA). Pedro is guest lecturer at the Portuguese Catholic University – Lisbon School of Law, and of the Autónoma Academy in Lisbon.

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Rato, Ling, Lei & Cortés – Advogados | Lektou

Calvin Tinlop Chui is a partner at Rato, Ling, Lei & Cortés who focuses on capital markets, banking and finance, insurance, corporate and M&A, and regulatory matters. In addition to being a member of the bond review committee of the Macau-licensed bond-related exchange, he is also a member of the supervisory committee of a local banking institution. Currently, he is serving as the president of the board of directors of the Macau Financial Law Association. He is qualified to practise in the Macau SAR and the State of New York.

Rato, Ling, Lei & Cortés – Advogados | Lektou

Macau Landmark Office Tower
Floor 23
Avenida da Amizade 555
2301-2304
Macau SAR
China

Tel: +853 2856 2322
Fax: +853 2858 0991
Email: mail@lektou.com
Web: www.lektou.com

律師事務所 RATO LING LEI & CORTÉS
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Rato, Ling, Lei & Cortés – Advogados | Lektou

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

The mainstays of the Macau Special Administrative Region's economy are the tourism and entertainment sectors.

The dominant forces in the growth and development of the Macau loan market – residential mortgage loans (RMLs) and commercial real estate loans (CRELs) – have encountered changes. According to the Macao Economic Bulletin – jointly published by the Macau Economic Bureau, the Monetary Authority of Macau (AMCM) and the Statistics and Census Service – new RMLs approved in Q1 of 2023 stood at MOP4,577 million, in comparison to MOP 8,271.8 million in Q1 of 2022 and MOP7,928.6 million in Q1 of 2021. Also, new CRELs approved in the same period in 2023 and 2022 witnessed a decrease of more than 309.02%.

Considering the current economic situation, the financial sector has been viewed as a fitting candidate to assist Macau in developing a more diversified economy. The government has made it clear that a series of actions will be taken to nurture a more prominent bond market in Macau. It is worth noting that this year the Ministry of Finance of the People's Republic of China and the Department of Finance of Guangdong Province have both returned to issuing government bonds in Macau.

While the economy has taken a hit, financial services and their regulatory framework are expected to embrace further developments in the near future, particularly in bonds, trusts and investment funds services.

1.2 Impact of the Ukraine War

The impact of the Ukraine war in Macau has been indirect. Consumer prices and inflation rates have remained steady and low.

1.3 The High-Yield Market

The issuance and listing of bonds in Macau is primarily confined to certain types of corporate entities, particularly the ones originating from Mainland China.

Traditional financing terms and structures therefore remain relatively unaffected.

1.4 Alternative Credit Providers

Credit activities are highly regulated in Macau and, in general terms, credit can only be provided by licensed banks and finance companies. Traditional banks aside, there is only one finance company that has been established in Macau. There has therefore been no significant growth in alternative credit providers.

1.5 Banking and Finance Techniques

Due to the economic surge in Macau over the past decade, traditional banks are actively promoting private banking and wealth management to serve high net worth individuals (HNWIs), which, in some cases, involves tailored lending and mortgage strategies.

More financial institutions have been extending their cross-jurisdictional abilities to companies and individuals engaged in businesses or transactions across the Pearl River Delta Metropolitan Region, including in neighbouring Hengqin Island, Hong Kong and Guangdong Province.

The authors expect that the number of Mainland companies issuing bonds in Macau will increase over time. Banks in Macau have become increasingly experienced in bond-related servic-

es, particularly underwriting and the custody of corporate bonds, as well as the management of corporate bonds issuance and trading. Recently, the Department of Finance of Guangdong Province has announced that it will issue renminbi-denominated offshore bonds in Macau.

1.6 ESG/Sustainability-Linked Lending

Environmental, social and corporate governance has been a topic for discussion in recent times among public authorities and NGOs. It is expected that policy development on this topic and sustainability-linked lending will continue to be discussed in the coming years.

2. Authorisation

2.1 Providing Financing to a Company

Only licensed banks, certain restricted licence banks and those financial institutions that have been properly constituted and authorised under the terms of the Macau Financial System Act (Law No. 13/2023) or special legislation – ie, the Finance Companies Act (Decree-Law No 15/83/M) – are allowed to provide, on a habitual basis and with a view to profit, lending, guarantees and other commitments, financial leasing and factoring in Macau.

Authorisation is granted by the Chief Executive of Macau on advice from the AMCM and, in general terms, entities willing to incorporate a credit institution in Macau should submit their application through the AMCM, accompanied by relevant information; inter alia:

- a memorandum demonstrating the economic and financial reasons for wishing to incorporate the institution, indicating its feasibility and the manner in which the same shall fit into the economic and financial policies pursued by the competent authorities of Macau;
- a description of the institution, giving its location and details of the technical and human resources at its disposal;
- a draft of the memorandum and articles of association; and
- personal and professional identification of the founding shareholders, indicating the percentage of their respective holdings in the share capital and a statement confirming the adequacy of the shareholding structure with regard to the stability of the institution.

The same information should be provided in relation to corporations that are direct or indirect holders of 5% or more of the credit institution to be incorporated. The AMCM may request any other information it deems necessary to allow a full analysis of the application.

The decision on the application for authorisation shall, inter alia, take into account:

- the suitability of the qualifying shareholders, including the ability of the institution to guarantee the safety of the funds deposited with it;
- the adequacy of the technical and financial resources required for the type and volume of transactions that the applicant proposes to conduct; and
- the adequacy of the objectives of the applicants with regard to the economic and financial policies pursued by the official bodies in Macau.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Any local or foreign entity in Macau that provides lending on a habitual basis and with a view to profit must abide by the regulations described in **2.1 Providing Financing to a Company**. The applicability of the requirements described does not depend on the origin of the entities.

Nonetheless, it is common for foreign institutions not registered in Macau to grant loans, including syndicated loans. This form of lending is not considered habitual, so it does not contravene the rules established by the Macau Financial System Act.

3.2 Restrictions on Foreign Lenders Receiving Security

There are no prohibitions imposed on granting security or guarantees to foreign lenders. However, in accordance with the Macau Commercial Code, companies cannot provide personal or real guarantees for the obligations of other persons, except if there is a personal interest in the company, declared and reasoned in writing by the administration body.

3.3 Restrictions and Controls on Foreign Currency Exchange

Macau is a free port and there are no general exchange controls or restrictions on, and regarding, foreign currency exchange.

3.4 Restrictions on the Borrower's Use of Proceeds

he use of the proceeds from loans or debt securities is determined by the agreements entered into by and between the lender and borrower, and, other than what has been agreed between the parties involved in the financing agreements, no restrictions exist on the borrower's use of proceeds from loans or debt securities.

3.5 Agent and Trust Concepts

The concepts of agent and trust are both recognised in Macau. The agent is commonly referred to as the "*mandatário*" and, in the context of loans, the agent mostly appears in a syndicated loan arrangement as an administrative figure.

At times, a special irrevocable power of attorney arrangement may be considered.

Trusts have been introduced into the Macau legal system since the enactment of Law No 15/2022 on 1 December 2022, the "Trust Law".

3.6 Loan Transfer Mechanisms

Credit assignment and contractual position assignment are the main loan transfer mechanisms that exist under Macau law.

By credit assignment, the lender can assign to any third party, partly or wholly, the credit in question, without the consent of the borrower, unless otherwise stated in the law or by agreement, or unless the credit is, by its very nature, linked to the personal quality of the lender. In the absence of any contrary agreement, credit assignment also transfers the associated securities to the assignee, as long as the securities can be transferred by the assignor.

By contractual position assignment, a party to a particular loan arrangement (in this case, the lender) can transfer its contractual position in its entirety to any third party only with the consent of the other party (in this case, the borrower).

3.7 Debt Buy-Back

Debt buy-back is not forbidden by law in Macau. However, when the market circumstances and

contractual terms are favourable, a borrower would more commonly consider repayment of the loan in advance.

3.8 Public Acquisition Finance

There are no particular rules under Macau law regarding "certain funds" with respect to public acquisition finance transactions.

3.9 Recent Legal and Commercial Developments

As mentioned in **3.5 Agent and Trust Concepts**, the Trust Law has been passed and entered into force in 1 December 2022, while Law No 13/2023 has been adopted to replace the Macau Financial System Act of 1993 (Decree-Law No 32/93/M, 5 July 1993). In addition, the government intends to speed up the drafting and legislation of laws and regulations concerning securities markets and investment funds.

3.10 Usury Laws

The general legal interest rate in Macau is fixed at 9.75% annually and any interest rates that are three times or more over the legal interest rate – ie, 29.25% or more annually – are considered as usury.

Without prejudice to a contrary written stipulation regarding methods for the determination and variation of interest rates, commercial interest rates are the same as the general legal interest rates, but 2% shall be added to the rate in the case of delayed repayment by a borrower.

3.11 Disclosure Requirements

Contracts depending on the underlying assets may be subject to registration requirements.

4. Tax

4.1 Withholding Tax

In accordance with the Macau Complementary Tax Law, there are no provisions for withholding taxes from payments made by local companies to foreign companies.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Banking operations are subject to stamp duty. The following are subject to such duty at a rate of 1% over the global amount of the profits determined:

- commissions relating to credit operations;
- banking service commissions and other banking profits, where these result from safe value activities; and
- intermediation of payments and administration of capital.

Nonetheless, there are statutory exemptions, including when the loan is granted by credit institutions authorised to operate in Macau.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

If a foreign lender or non-money centre bank has a physical presence in Macau that meets the criteria of a permanent establishment, it may be subject to tax on its business profits derived from Macau. It is important to assess whether the activities carried out within Macau constitute a potential permanent establishment and consider the potential tax implications accordingly.

5. Guarantees and Security

5.1 Assets and Forms of Security

The assets typically available as collateral to lenders are real estate property (eg, urban and rural properties), movable property (eg, cars, ships, aircraft, company shares and quotas, and IP) and receivables (eg, deposits, income, proceeds from insurance claims, and rights to payment).

The applicable formalities and perfection requirements generally conform to those that are applied to the constitution or acquisition of the assets, ranging from a simple agreement between the parties, to a public deed with the intervention of a notary public, possibly with the additional requirement of completing the registration of the security with the competent public authorities (eg, the Real Estate Assets Registry or the Commercial and Movable Assets Registry).

The essential consequence of not completing the above requirements renders the respective security invalid and/or unenforceable against any third party.

The timing and costs involved in arranging any of the above security measures vary and will depend on the complexity of the respective formalities and perfection requirements.

5.2 Floating Charges and/or Similar Security Interests

The Macau Commercial Code permits that a floating charge be granted over all present and future assets of a company, provided that certain prerequisites are fulfilled.

5.3 Downstream, Upstream and Cross-Stream Guarantees

There are no general or associated limitations or restrictions on downstream, upstream and cross-stream guarantees. However, in accordance with the Macau Commercial Code, companies cannot provide personal or real guarantees for the obligations of other persons, except if there is an own interest in the company, declared and reasoned in writing by the administration body.

5.4 Restrictions on the Target

The general rule is that companies cannot provide personal or real guarantees for the obligations of other persons, except if there is an own interest in the company, declared and reasoned in writing by the administration body. Therefore, unless the target being acquired satisfies the above requirements, any guarantees, security or financial assistance for the acquisition of its own shares would be null and void.

5.5 Other Restrictions

Besides the general rule mentioned in **5.4 Restrictions on the Target**, restrictions are imposed on credit institutions (eg, banks) to limit their exposure to the holders of qualifying holdings – ie, any person, individual or corporate that has, directly or indirectly, a qualifying holding in them – or to companies over which this person has direct or indirect control. Additionally, the aggregate exposure of all holders of qualifying holdings and companies may not exceed, at any time, 40% of their own funds.

Such operations require approval from all the members of the credit institution's board of directors and a favourable opinion from its supervisory board, and the AMCM shall also be notified of the respective terms within ten days, counted from the date of the respective approval.

Specific limits are also imposed on:

- exposures to the security of the company's own shares;
- the members of its board of directors and supervisory board, their spouses (as long as they are not judicially separated or married under the regime of separate property), children, parents, stepchildren, step-parents, sons-in-law, daughters-in-law, parents-in-law, or companies under their control or the board of directors or supervisory board to which they belong; and
- each employee.

5.6 Release of Typical Forms of Security

The typical forms of security are released through the same requirements and formalities applicable to the perfection of the constitution of securities, which may require a deed of discharge and release, as well as cancellation of the respective registration with the competent public authorities, depending on the type of security and assets granted in the security.

5.7 Rules Governing the Priority of Competing Security Interests

The general rule governing the priority of competing security interests is the date of perfection of security (eg, registration of the security with the competent public authorities, when registration is required). Contractual prioritisations/subordination made within the legal limits are allowed in Macau and are enforceable between parties. However, for contractual subordination provisions to fully survive the insolvency of a borrower, there must be sufficient funds to satisfy more senior creditors before the parties to the contractual subordination provisions. Otherwise, the priority of the creditors will be corrected in accordance with the legal priority.

Privileged Credit

Despite the above, the concept of privileged credit is set forth by the Macau Civil Code, which defines it as "the faculty that the law, considering the credit involved, grants to certain creditors, independently from registration, of being paid in detriment of other creditors."

Unlike secured credit (eg, through a mortgage or pledge), privileged credit does not need to be registered and it is the highest-ranked form of credit, having first priority over other obligations of the debtor.

According to the Macau Civil Code, privileged credit is of two types:

- general movable privileged credit, which covers the entire value of the assets when the assets are seized or frozen; and
- special privileged credits, which covers the amount of determined assets.

The ranking of privileged movable credit is as follows:

- the Macau SAR (ie, the State) has a privileged movable credit to secure direct and indirect taxes regarding the year in which the assets were frozen or seized and for the previous two years;
- credit of the debtor related to medical treatment or of persons who are dependent on the debtor, related to a period of six months as from the request for payment;
- credit for expenses absolutely necessary to the existence of the debtor or of persons who are dependent on the debtor as from the request for payment;
- credit emerging from a labour contract or related to the termination or cessation of a

labour contract in relation to a period of six months as from the request for payment; and
- the funeral expenses of the debtor.

As far as special privileged credit is concerned, under the Macau Civil Code, it is stated that:

- the court fees spent in the common interest of the creditors to maintain, enforce or liquidate assets have preference over these assets;
- the credit of a victim that covers civil liability has preference over the compensation owed by the insurer of such civil liability that the liable party has incurred;
- the credit of the author of intellectual property emerging from a publishing contract has preference over the copies of the property existing in the power of the publisher; and
- the real estate taxes and those payable for the transfer of assets have preference over, respectively, the income of these assets and these assets.

Liquidation of Assets

Whenever there is a liquidation of assets, the ranking of privileged assets is as follows:

- credit related to court fees;
- credit of the Macau SAR for taxes;
- credit of a victim that implies civil liability;
- credit for intellectual property;
- credit of the debtor related to medical treatment or of persons who are dependent on the debtor, related to a period of six months as from the request for payment;
- credit for expenses absolutely necessary to the existence of the debtor or of the persons who are dependent on the debtor as from the request for payment;
- credit emerging from the labour contract or related to the termination or cessation of the labour contract in relation to a period of six months as from the request for payment; and
- the funeral expenses of the debtor.

All the aforesaid privileged credits have priority over the secured credits.

5.8 Priming Liens

The principle of "first in time, first in right" generally applies in Macau. The priority of security interests is determined based on the order of registration or perfection. Typically, the first security interest registered or perfected will have priority over subsequent security interests. In order to establish priority and protect a lender's security interest, it is advisable to register the security interest with the relevant public registry or authority. In Macau, the Commercial and Movable Assets Registry is responsible for registering security interests over movable assets, while real estate mortgages are registered with the Real Estate Assets Registry.

To structure around priming liens, lenders may consider various methods, including the following:

- Obtaining subordination agreements: lenders can negotiate subordination agreements with existing lienholders, where the existing liens are subordinated to the lender's security interest – this agreement establishes the priority of the lender's security interest over the existing liens.
- Taking additional collateral: lenders may require additional collateral from the borrower that is not subject to existing liens – by securing additional assets, the lender can create a separate security interest with a higher priority.
- Perfecting security interests promptly: timely registration or perfection of the security inter-

est is crucial to establish priority – lenders should ensure that all necessary steps are taken promptly to record their security interests with the relevant registries.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

A secured lender can enforce its collateral in accordance with the terms and conditions set out in the loan agreement, with collateral entered by and between the secured lender and borrower. Typically, securities and guarantees can be enforced judicially or, when certain circumstances are met, out of court.

Once there is a default, the secured lender may enforce its security against the borrower. With certain securities – such as a mortgage, promissory notes and other types of executive titles – the proceedings can be initiated without going through declarative proceedings and the secured lender can submit an application to the court already listing the assets of the borrower and requesting that such assets be seized.

6.2 Foreign Law and Jurisdiction

The choice of a foreign law as the governing law of the contract and the submission to a foreign jurisdiction are, in general, upheld under Macau law.

Particular attention has to be paid to the relevance of the choice of a foreign law and the exclusivity of the Macau court's jurisdiction (eg, location of the collateral).

Waiver of immunity for civil matters is only valid if made in accordance with local legislation and international, regional and bilateral agreements, particularly with respect to the nature of the underlying collateral, person and entity.

6.3 Foreign Court Judgments

The courts of Macau recognise a judgment from foreign courts through a special proceeding called "Revision and Confirmation of Foreign Judgments", unless regulated otherwise in an international treaty applicable in the Macau jurisdiction, an agreement under judiciary co-operation, or special law (meaning any law, decree or government decision that falls outside that general rule/provision).

The following conditions also need to be fulfilled:

- No doubts about the authenticity of the document containing the foreign judgment, or its meaning, should arise.
- The foreign judgment is final and no appeal is possible under the applicable laws.
- The foreign judgment was not obtained fraudulently and was not issued on one of the matters for which the Macau courts consider themselves (by law) to have exclusive jurisdiction. The courts of Macau consider themselves as having exclusive jurisdiction to decide upon ownership rights cases over immovable assets located in Macau (lex rei sitae), as well as bankruptcies of companies with their registered main office in Macau.
- No identical suit is pending before a court in Macau and no identical suit has already been judged by a Macau court.
- Due process and equitable rights were granted to the parties by the foreign courts.
- The foreign judgment obtained does not violate any public policy of Macau.

The decision of the arbitral tribunal is enforceable in the Macau courts of general jurisdiction under the same terms as a decision rendered

by a court. In addition to the regime for internal arbitration, a specific regime for commercial external arbitration is provided for in Decree-Law No 55/98/M (23 November 1998). This regime is similar to the United Nations Commission on International Trade Law (UNCITRAL).

With regard to recognition in the Macau SAR of arbitral decisions made abroad, the general rule established for court decisions is also applicable to arbitral awards. Given this, for a foreign arbitral decision to be executed in Macau, the decision shall first be revised and confirmed by a Macau court, except if there is an agreement between both jurisdictions exempting this.

6.4 A Foreign Lender's Ability to Enforce Its Rights

There are no matters that might significantly impact a foreign lender's ability to enforce its rights under a loan or security agreement in Macau, except that all the documents to be submitted to the Macau courts are required to be translated into either of the two official languages: Portuguese or Chinese.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

The declaration of insolvency determines the closure of the company's current accounts, the immediate maturity of all debts, the cessation of the accrual of interest or other charges on the obligations of the company, and the termination of any actualisation of the obligations to which the company is subject.

The declaration of insolvency also precludes the initiation or continuation of any proceedings against the company.

7.2 Waterfall of Payments

Under the Macau Civil Procedure Code, payment is immediately made to the creditors with real estate collateral, upon having liquidated the assets, and if such creditors are not paid in full, they are then included among the common creditors.

The rules for the order of payments are distributed throughout the Macau Civil Code, and a systematic approach can be used to interpret the rules and determine the order for income assignment, pledge, mortgage, privileged credit and lien, as well as the relationship between the creditor and the company.

7.3 Length of Insolvency Process and Recoveries

The duration of insolvency proceedings in Macau can vary significantly depending on the complexity of the case, the size of the company, the co-operation of the parties involved, and other factors. In some cases, the process can take several months to a few years to complete. The exact timeline will depend on the specific circumstances and the efficiency of the legal system.

The recovery rates for creditors in insolvency proceedings can also vary. In Macau, the goal of insolvency proceedings is to ensure the fair distribution of the insolvent company's assets among its creditors. However, the actual recovery for creditors will depend on several factors, including the value of the company's assets, the priority of creditor claims, the existence of secured creditors, and the overall financial situation of the company.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Under Macau law, there is no alternative to insolvency proceedings. However, under this process, it is possible to have an agreement between the creditors or for the bankrupt party to request that the court reduce the credit, which, if accepted by the court, will be proposed to the creditors, who may vote on such a request.

7.5 Risk Areas for Lenders

Further to **7.1 Impact of Insolvency Processes**, the borrower, security provider or guarantor should note that, as a general rule, any transactions executed by the company in question after the judicial ruling of insolvency are not enforceable against the insolvent estate.

Securities granted in bad faith, with the purpose of deliberately avoiding payment to creditors, can also be annulled or declared null and void. For example, any real estate securities granted one year before the date of the judicial ruling of insolvency, where the granting of such only occurred after the debts had been incurred, and any real estate securities granted 90 days before the judicial ruling of insolvency, where the granting of such occurred simultaneously with the incurrence of debts, can be declared null and void by the court.

8. Project Finance

8.1 Recent Project Finance Activity

At present, there is no specific legislation on project finance in Macau. Therefore, the general legislation regarding financing and lending is applicable to each project being financed.

Integrated resort complexes and infrastructure are major targets for project finance in Macau, and the future development trends of project finance depend on the emergence of these types of project.

8.2 Public-Private Partnership Transactions

Public-private partnerships have been embraced by the government in numerous areas, such as water, electricity, airport operation, transport, education and telecommunications.

The general legislation applicable to a public-private partnership is the Macau Administrative Procedure Code, and the specific legislation applicable is Law No 3/90/M, establishing the general principles to be observed in the concessions of public works and public services.

8.3 Governing Law

As mentioned in **8.1 Recent Project Finance Activity**, the general legislation regarding financing and lending described in **2.1 Providing Finance to a Company** is applicable to each project being financed.

8.4 Foreign Ownership

Macau's Land Law stipulates that only all lands of Macau, except for private lands that have been legally confirmed before the establishment of the Macau Special Administrative Region, belong to the People's Republic of China (PRC) and are managed, used, developed, leased or granted by the government of the Macau Special Administrative Region to individuals or legal persons for use or development. Foreign entities, without specific authorisation, are generally not allowed to directly own real property. However, there are exceptions and special provisions for certain sectors or projects, such as public interest projects or projects of strategic importance to Macau's development.

Macau law does not explicitly restrict foreign lenders from holding or exercising remedial rights on liens over real property. However, it is important to note that the enforcement of liens and related rights is subject to the specific provisions of Macau's Civil Procedure Code. The enforcement process and the extent of the rights of foreign lenders would be governed by this code and related regulations.

8.5 Structuring Deals

As mentioned in **8.1 Recent Project Finance Activity**, the general legislation regarding financing and lending described in **2.1 Providing Financing to a Company** is applicable to each project being financed. Furthermore, the form of the project company can be chosen within the typical legal forms and there are no general restrictions on foreign investment.

8.6 Common Financing Sources and Typical Structures

Project finance transactions would typically be managed by forming a special purpose vehicle (SPV), involving a range of financing tools, such as bank financing, export credit agency financing and project bonds.

8.7 Natural Resources

In accordance with the Basic Law of Macau, the land and natural resources within the region are regarded as state property, except for private land recognised as such according to the laws in force before the establishment of the Macau SAR. The government is responsible for the management, use and development of state property and for leasing or granting it to individuals or legal persons for use or development. The revenues derived therefrom shall be exclusively at the disposal of the government of the region.

8.8 Environmental, Health and Safety Laws

The environmental, health and safety laws applicable to projects are also applicable in general circumstances.

The guidelines and fundamental principles governing environmental policy in Macau are set out in Law No 2/91/M, dated 11 March 1991 (the "Macau Environmental Law"), which seeks to enhance the protection and sustainable development of the environment. As a general principle, the Macau Environmental Law prescribes that everyone has the right to an ecologically balanced environment, as well as a duty to collectively promote an improved quality of life.

In order to achieve this goal, all projects and constructions that may affect the environment or the health of citizens must be subject to a preliminary environmental impact assessment. Moreover, the Macau Environmental Law prescribes that violations of environmental legislation will be punished with civil liability, administrative fines or criminal liability (Article 268 of the Macau Criminal Code prescribes this for pollution-related crimes), depending on the degree of the violation in question. Also, injunctions may be granted in order to put a stop to environmental infringements. The regulatory authority in charge of monitoring environmental protection matters is the Environment Protection Services Bureau. However, police authorities are also legally entitled to impose preventative measures with respect to time period restrictions.

Regarding water and marine pollution, in particular, Decree-Law No 46/96/M defines the technical conditions that must be satisfied in order to ensure the global functioning of the public water distribution system, the preservation of public health, and the safety of the users and the instal-

lations, whereas Decree-Law No 35/97/M provides for the protection of the marine environment from pollution. The latter further prohibits the discharge of any solid or liquid residues – in particular, petroleum or chemical substances – that may contaminate marine water, beaches or coastal areas, and affect their flora and fauna.

As an employer, a contractor has to comply with the conditions prescribed under Decree-Law No 44/91/M (the "Regulation of Working Safety and Hygiene in the Construction Industry") and Decree-Law No 34/93/M (the "Legal Regime of Noise at Work"), in order to provide safe, clean and environmentally friendly working conditions for employees. Failure to comply with those rules may result in the application of fines, according to the provisions set out by Decree-Law No 67/92/M (the "Sanctions Regime for Non-compliance with the Regulation of Work Safety and Hygiene in the Construction Industry") and Decree-Law No 48/94/M (the "Sanctions Regime for Non-compliance with the Legal Regime of Noise at Work").

Regarding the working environment in general, an employer must comply with the rules provided under Decree-Law No 37/89/M (the "General Regulation of Work Safety and Hygiene of Offices, Services and Commercial Establishments"), in order to provide a safe and clean working environment for its employees. Failure to comply with those rules may result in the employer being fined, according to the provisions set out by Decree-Law No 13/91/M (the "Sanctions for Non-compliance with the General Regulation of Work Safety and Hygiene of Offices, Services and Commercial Establishments").

MALDIVES

Law and Practice

Contributed by:
Mohamed Shahdy Anwar, Zain Shaheed and Fathimath Lamaan
S&A Lawyers LLP

Contents

S&A Lawyers LLP is renowned for offering services in relation to the full spectrum of financial products, including lending and acquisition finance, asset finance and structured project finance. The firm acts for a diverse portfolio of clients, including international financial institutions, foreign and local banks and state-owned companies, and its lawyers are highly regarded for proposing dynamic solutions to complex financing transactions. The firm has advised leading banks from around the world on financial transactions relating to tourist resort and investment acquisitions in the Maldives, and has advised several foreign incoming investors new to the tourism and real estate market on almost all major inward investments in the sector.

Authors

Mohamed Shahdy Anwar is the managing partner and heads the corporate and commercial team at S&A Lawyers LLP. He is highly regarded in the market and has invaluable experience in private legal practice, advising various corporations and entities on a wide variety of corporate and commercial issues, including project financing for tourism and infrastructure projects; he also advises major international banks and financial institutions on lending for projects in the Maldives and abroad, and also in related litigation. Shahdy is highly regarded as a leading individual in the corporate and commercial field and has received many accolades and recognitions for his practice over the years.

Zain Shaheed is the head of the litigation and arbitration practice at S&A Lawyers LLP and handles contentious banking and finance matters. He began working in the City of London at the height of the financial crisis, where he was involved in landmark disputes relating to the LIBOR/TIBOR fixing scandal, the interest rate swaps scandal, and the subsequent implementation of voluntary remediation programmes of large financial institutions run by the Financial Conduct Authority of the United Kingdom. Zain has also advised large wealth fund managers, clearing houses, banks and other financial institutions in relation to disputes arising out of complex trust structures, CDOs, fx products and high-risk trading items such as indices and CFDs, in addition to advising on disputes relating to more conventional facilities.

Fathimath Lamaan plays a leading role in the corporate and commercial team at S&A Lawyers LLP, with banking and finance being a key area of expertise. She has a wealth of experience in representing foreign real estate funds, investment firms and companies in acquisition deals relating to tourism, in addition to acting as local counsel for the related financing for such acquisitions. Lamaan has also acted for foreign banks and institutions on several cross-border financing and public offering deals, including the offering of high-value bonds by the Maldivian government and other state-owned companies.

S&A Lawyers LLP

#02-01 H. Millennia Tower,
10 Ameer Ahmed Magu
Male' 20026
Republic of Maldives

Tel: +960 3013200
Email: info@sandalawyers.com
Web: www.sandalawyers.com

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1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

The liquidity ratio of the Maldives financial industry slightly increased in 2023 as compared to 2022. There has been a continued decline in lending from Sri Lankan banks due to the economic crisis in Sri Lanka. However, this has created room for other foreign banks such as those from Singapore and the People's Republic of China, to fill the gaps in the lending market.

The Maldives government is currently active in providing financial assistance, mainly to small businesses, through various financial aid and lending schemes. However, there has been a noticeable decline in these activities year on year from 2021, 2022 to 2023.

Both the government and private parties continue to seek assistance from international and local financial institutions to refinance and restructure their existing debt, owing to the increase in inflation in 2022 and 2023, primarily due to the conflict between Russia and Ukraine.

1.2 Impact of the Ukraine War

The war in Ukraine has deeply impacted the Maldives, particularly due to its strong economic ties with Russia and Ukraine. Following the suspension of international flights by Russian airlines, the Maldives has experienced a marked decline in tourists from Russia, which had been the leading source of visitors prior to the conflict. This is particularly significant as Russian and Ukrainian tourists typically contribute more revenue to the Maldivian tourism sector than visitors from other countries.

However, the country's economy has been able to maintain moderate growth primarily due to an upswing in tourist arrivals from other countries and capital spending. Whilst inflation rates rose in 2023 due to the impact of the war and the increase in general goods and services tax from 6% to 8%, and from 12% to 16% for the tourism sector, the Maldives Monetary Authority forecasts real GDP growth of 9.4% for the year. This projection is notably higher than the World Bank's estimate of 6.6%.

The government has not implemented any new special measures in the form of financial aid or otherwise for those affected by the Russia-Ukraine conflict. However, the government continues to be active in supporting small businesses.

1.3 The High-Yield Market

Interest rates of retail banking products targeting individuals are between 10% and 19%, which may be considered high-yield by international standards. Interest rates above 12% may be considered high-yield in other jurisdictions, but such interest rates are considered conventional in Maldives.

Interest rates of between 18% and 25% are considered high-yield in a Maldivian context. These loans usually relate to short-term and/or domestic/household borrowing needs. These facilities are not normally backed by security and have relatively low eligibility requirements. Therefore, there continues to be high demand for facilities with these interest rates, as there has been for some years now.

There are no emerging trends affecting the financing terms and structures of conventional loans as a result of the high-yield market, largely because the high-yield market targets a different borrowing group and relates to different borrowing needs. The high-yield market therefore has

not in any meaningful way encroached on the conventional loan market share.

1.4 Alternative Credit Providers

The Maldives has not seen significant growth in alternative credit providers.

There is a small unregulated private loan market, but the market share of these private lenders is too small for it to have any meaningful impact on the financing terms and structures of conventional loans.

1.5 Banking and Finance Techniques

Local banks and financial institutions have been slow to respond and adapt to new trends in the loan market, which has led to an increase in borrowing from foreign banks or financial institutions. For instance, local banks have struggled to compete with foreign lenders in attracting financing deals from the large-scale foreign direct investments made in Maldives in tourism, real estate or infrastructure. In this regard, the Maldives' local banks are a long way from catching up with their foreign counterparts in the project finance market.

In terms of evolving techniques to reflect the needs of the domestic borrower base, there has recently been an increase in Islamic finance or Sharia-compliant banking products being introduced to cater to the needs of local borrowers. There are no other notable finance techniques evolving in Maldives to reflect the investor base and needs of borrowers.

1.6 ESG/Sustainability-Linked Lending

The Maldives' ESG Credit Impact Score is deeply negative, signalling the nation's heightened vulnerability to both natural hazards and social issues. For many years, the nascent legal framework in the realm of financial administration has impeded the government's capacity for effective oversight and control of corruption, money laundering, and other financial crimes. Recent legislative enhancements have expanded the mechanisms for countering corruption, yet the challenges of addressing financial crimes and money laundering persist.

The Maldives is extremely vulnerable to natural hazards, with climate change and rising sea levels posing significant threats to both lives and livelihoods. The government is investing in large land reclamation projects such as the construction of the artificial Hulhumalé island to relocate people most threatened by rising sea levels.

The Maldives also has a number of social issues. Given the low and dispersed population, logistical challenges abound, notably evidenced by a scarcity of skilled labour and specialised expertise. This situation exacerbates youth unemployment and leads to diminished female workforce participation. To combat these issues, the government is making sustained investments in educational opportunities.

In light of these challenges, the Maldives continues to benefit from development and conservation aid, receiving grants and loans from several international bodies, including the Asian Development Bank, which funds environmental conservation, and the United Nations Development Programme, which funds awareness campaigns, among other initiatives.

2. Authorisation

2.1 Providing Financing to a Company

The Banking Act (Law No 24/2010) is the primary law regulating banks, financial institutions and banking services in the Maldives. All activities of

banks and financial institutions are overseen and regulated by the central bank – ie, the Maldives Monetary Authority (MMA).

Providing Banking Services in the Maldives

A licence issued by the MMA must be obtained prior to commencing any of the following activities:

- engaging in banking business outside the Maldives through the use of a company that is organised under the laws of the Maldives or operates from offices located in Maldives;
- opening a branch or a subsidiary in the Maldives of a domestic or foreign bank;
- opening a branch or representative office outside the Maldives of a domestic bank or of any bank operating from offices located in the Maldives; and
- operating a representative office in the Maldives of a foreign bank.

In the case of domestic entities, licences are only granted to companies that are registered under the Companies Act (Law No 10/96); in the case of branches or representative offices of foreign banks, licences can be granted to companies that are registered under the respective companies acts of their jurisdiction of incorporation. Previously, all foreign investment applications were reviewed on a case-by-case basis. However, following the new Foreign Direct Investment Policy, which came into effect in 2020, express provision has been created for 100% foreign-held companies to be allowed to incorporate and provide banking and related services. There continues to be a requirement for at least two shareholders and at least one resident to sit on the board of directors.

Licences are granted in writing and can be valid for an indefinite period of time. Licences are not assignable or transferable. The licence or its attachments shall specify the conditions under which it is issued, and compliance with all conditions of licensing is a continuing requirement for all licensees, unless such conditions are later modified.

Licences are applied for in writing to the MMA. Said application has to be in the form prescribed by the MMA from time to time, and must contain all requested information. The MMA prescribes different application forms and different informational requirements for the various categories of licences available. Under the Banking Act (Law No 24/2010), the MMA has discretion to determine the procedures that it will use to evaluate applications for licences.

The information submitted with the application for a licence must include at least the following:

- an authenticated copy of the charter and corporate governance documents of the applicant, and of its audited annual balance sheets and profit and loss statements for the last three years;
- a description of the proposed capital funds of the applicant, the sources of such funds and the amount that has been paid in (the MMA has discretion to require that the intended capital funds be deposited with the MMA, or another depository approved by the MMA, together with a certification that there is no encumbrance on such funds);
- the premises and the addresses at which the applicant proposes to do business, and the name under which the applicant intends to conduct its banking business;
- the names, places of permanent residence, business and professional backgrounds, and other biographical and financial data to be determined by the MMA, of each proposed

major shareholder and administrator of the applicant;
- for each major shareholder and administrator, an affidavit duly signed by the individual stating any convictions for crimes or no conviction, and any involvement in a managerial function in an insolvent company or a company subject to insolvency proceedings, if any (the standard text for such affidavit may be determined by the MMA);
- a business plan describing the objectives and business activities intended for the proposed entity, including a description of its organisational structure and internal controls, including measures appropriate to counter money laundering and the financing of terrorism, together with projected balance sheets, profit and loss accounts and cash flow statements for the first three years of operations; and
- in the case of an application by a foreign bank or bank holding company, or the subsidiary of such foreign bank or bank holding company, a statement from the foreign supervisory authority responsible for the prudential supervision of the foreign entity to the effect that it has no objection to the proposed establishment of operations in the Maldives by the applicant; this statement shall also state that such authority will exercise consolidated supervision over the applicant.

In the case of an application by a bank holding company or bank to organise a domestic bank, the MMA must obtain detailed financial and operational information regarding the prospective licensee, in addition to the information listed above. This information must also include details of the major shareholders and administrators of the applicant bank or bank holding company. The MMA may use this information to determine the following:

- that the ownership by the bank holding company or bank will not weaken the subsidiary bank but will bring financial and managerial resources that will benefit the domestic subsidiary bank; and
- that the major shareholders and administrators of the bank holding company or bank are fit and proper persons.

In the case of an application by a foreign bank to open a branch or representative office in the Maldives, the MMA may request any additional information that it believes to be pertinent to the proposal. It can also request the applicant to provide financial and biographical information regarding the persons to be designated as branch manager or representative office manager, as the case may be.

Applications for licences are to be accompanied by an application fee payable to the MMA in such amounts as the MMA may prescribe from time to time.

Applicants applying for a licence are required to act expeditiously in providing the required information, as well as any other information requested by the MMA for the purposes of processing the application. If an applicant fails to complete their application filing requirements within three months of applying for the licence, the MMA has the discretion to deem the application to have been abandoned and the application fee forfeited.

Providing Cross-Border Services

Cross-border lending is not regulated by the MMA, so foreign banks, financial institutions or non-banks do not require any permits or licences to provide financing to a company or party in the Maldives. Licences may be granted to foreign banks only if they are subject to consoli-

dated supervision by a supervisory authority in the country in which the foreign bank maintains its head office, and which the MMA determines to be adequate.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

There are no restrictions on foreign lenders granting loans to borrowers in the Maldives. There are no requirements to obtain registrations or licences, as cross-border lending is not regulated by the MMA.

Borrowers who may wish to remit proceeds from the Maldives to service their debts will need to consider the taxation implications they may face if they wish to borrow from a foreign lender that is a bank or non-bank financial institution not approved by the Commissioner General of MIRA. This is because payments made in relation to interest or to a payment that is economically equivalent to interest (excluding principal amount), including any commitment, guarantee or service fee, are liable for Non-Resident Withholding Tax (NWT) if they are paid to a bank or non-bank financial institution that is not approved by the Commissioner General. Therefore, NWT may act to disincentivise borrowers from taking loans from foreign lenders that are not approved by the Commissioner General, which may act as an indirect restriction on such unapproved lenders. As the NWT is relatively recent, whether this taxation will have an effect on foreign lending is yet to be determined.

3.2 Restrictions on Foreign Lenders Receiving Security

There are no restrictions or impediments on the granting of security or guarantees to foreign lenders per se, but mortgages on tourist developments are subject to obtaining a written mortgage approval from the Ministry of Tourism, as required under the Grant of Rights Regulation (Regulation No 2010/R-14). Once the mortgage agreement has been executed, the mortgage must then be registered with the Ministry of Tourism and a mortgage registration fee of MVR10,000 shall be payable to MIRA.

Securities over residential land do not require prior approval, but there is a formality to register the mortgage with the relevant authorities – ie, the city or local council, depending on the location of the residential land over which the mortgage has been created.

3.3 Restrictions and Controls on Foreign Currency Exchange

There are no restrictions, controls or other concerns with respect to foreign currency exchange in Maldives. Parties wishing to engage in the business of foreign currency exchange can do so by obtaining a licence from the MMA, pursuant to the relevant regulations, including the Money Changers Regulation (1987).

3.4 Restrictions on the Borrower's Use of Proceeds

There are no restrictions on the borrower's use of proceeds from loans or debt securities, although general requirements under the Prevention of Money Laundering and Financing of Terrorism Act (Law No 10/2014) must be complied with.

Restrictions may also be imposed under the contract governing the underlying loan or debt securities, wherein the borrower's use of proceeds should be in line with the conditions or purpose of financing set out in the loan agreement.

3.5 Agent and Trust Concepts

There are no statutes or regulations governing trusts or agency law in the Maldives.

The agency principle has been in practice for quite some time and is governed largely under the respective contractual arrangements between the parties.

Trusts have been recognised through precedent-setting Supreme Court judgments in two different cases, where the Supreme Court recognised the existence of implied trusts. Distinctions were not drawn between resulting and constructive trusts. Trust structures have therefore not been heavily utilised locally.

The treatment of beneficial ownership as being distinct and separate to legal ownership has not sufficiently matured in the Maldives. Notwithstanding the aforementioned Supreme Court judgment, the long-standing practice has been that only legal ownership is strictly recognised in the Maldives. Trust structures, if one were to arise at all, are likely to arise out of usually unwritten, implicit and likely unwitting understandings between parties and by operation of law as established in the recent Supreme Court judgment.

Offshore trusts are being utilised in transactions.

Despite the absence of a specific statute governing trusts in the Maldives, the Banking Act allows the provision of trust services as a banking service.

Lenders should approach trust instruments in the Maldives with caution as the principles and parameters of trust and agency law are not clearly defined and are not contained in a governing statute. It would be ideal for all rights and obligations with respect to trust and/or agency concepts to be expressly included in the deed/contract in order to guarantee protection.

3.6 Loan Transfer Mechanisms

There are neither statutory requirements nor any precedent-setting case law on loan transfer mechanisms.

Loan transfers can be done contractually through assignment, sale and novation of the loans. The lender may include an express provision in the underlying contract allowing such a transfer, and incorporate the requirements and protections into the contract.

Securities granted to the original lender may be released after the existing agreements are terminated and the borrower has entered into new agreements with the new lender (or a tripartite agreement with the original and new lender where the securities are transferred in favour of the new lender).

3.7 Debt Buy-Back

Debt buy-back is not regulated nor commonly practised in the Maldives. However, it is common for debt buy-back and the relevant procedure/mechanisms to be subject to the requirements contractually agreed between the parties.

3.8 Public Acquisition Finance

There is no requirement under Maldivian law for the buyer to show that it has “certain funds” in order to acquire a target. Much like most M&A activities in Maldives, this is unregulated.

However, parties are free to agree on conditions precedent, and lenders may therefore include certain funds provisions as part of the conditions precedent required from a buyer. A seller’s existing lender may also impose such a requirement

as part of the refinancing conditions precedent prior to completion. Ultimately, certain funds protection is one which the lenders ought to acquire from the seller/buyer of a transaction as appropriate. For any transaction, lenders must independently evaluate how much evidence and assurance they need regarding "certain funds", and must obtain and review such documentation ahead of completion as there is no statutory protection to rely on.

In terms of documentation, local Maldivian banks provide debt financing on the basis of in-house standard documentation (consisting of general terms and conditions). This should be considered "short form". International banks in the Maldivian loan market generally refer to the "long form" documentation, which is usually structured and drafted in line with the standards of the Loan Market Association. Upon execution, these documents do not normally need to be filed publicly, save for any securities such as mortgages over tourist developments or residential land, which need to be filed with the Ministry of Tourism and relevant city/island council, respectively.

3.9 Recent Legal and Commercial Developments

There are no recent legal and/or commercial developments that have required changes to legal documentation in banking- and finance-related matters.

3.10 Usury Laws

There are no usury laws limiting the amount of interest that can be charged.

Usury is a controversial topic in the Maldives. The Constitution of the Maldives requires that "tenets of Islam" shall be maintained in all dealings. Under this broad constitutional provision, inordinately high-yield loans could be challenged as usurious. However, this has not yet been regulated through statute and there has not been any precedent-setting case law on this point. This should reassure any lender, as loans charging compound interest of up to 25% per annum interest have not been challenged as usurious.

While there are no defined limits on how much a lender may charge as interest, it should be noted that the tax legislation of the Maldives allows a deduction of only 6% of interest as "deductible expenses" in computing taxable profit where the bank or financial institution is not approved by MIRA.

Furthermore, in applying the thin capitalisation rule, only 30% of the tax EBITDA may be deducted as interest in computing taxable profits.

3.11 Disclosure Requirements

Certain financial contracts may be requested by MIRA in the completion of an audit of the finance party. Save for this, there are no other regulatory requirements on disclosure of financial contracts.

However, it is worth noting that the Maldives has recently implemented new Civil Procedure Rules, containing expansive disclosure obligations that did not previously exist. This opens up the possibility that financial contracts may have to be disclosed during contentious proceedings before Maldivian courts.

4. Tax

4.1 Withholding Tax

From 1 January 2020, payments made in relation to interest or a payment that is economi-

cally equivalent to interest (excluding principal amount), including any commitment, guarantee or service fee, are liable for NWT if they are paid to a bank or non-bank financial institution that is not approved by the Commissioner General of MIRA. The term "interest" also includes any discounts, premiums, passive interest and profit in respect of any Islamic financial instrument.

Any bank or non-bank financial institution that is licensed by the central bank of its respective jurisdiction is considered an approved bank or non-bank financial institution; selected international financial institutions are also considered to be approved entities for this purpose. A full list of approved banks or non-bank financial institutions is available here.

From 1 January 2020, any interest payment made to a party other than those approved by the Commissioner General of MIRA is liable for NWT at the rate of 10% on the gross amount. Furthermore, NWT is payable on a monthly basis to MIRA and, in order to determine the period in which the NWT is to be settled, the earlier of the paid or payable date (determined as per the relevant accounting standard) is to be considered.

4.2 Other Taxes, Duties, Charges or Tax Considerations

All businesses are currently taxed under the Income Tax Act, including banks. The Maldives currently has a worldwide tax system, where the tax base is calculated based on the tax residency of the entity. Where a lender is a tax resident in the Maldives in a given tax year, its tax base is its worldwide income after the deduction of allowable expenses. If the lender is a non-tax resident in the Maldives in a given tax year, the tax base of the lender is only income sourced in the Maldives. Under the Income Tax Act, banks are charged a flat rate of 25% on their taxable income.

Lenders who have obtained a licence from the MMA are not required to register or charge Goods and Service Tax (GST) as the service falls within the definition of "financial services", which is exempted for the purpose of the Goods and Services Tax Act (Law No 10/2011).

4.3 Foreign Lenders or Non-money Centre Bank Lenders

There are no specific tax concerns if funds are borrowed for a business purpose that generates a taxable income in the Maldives, provided that the lender is not an associated party (as defined in the Income Tax Act) of the borrower.

However, if funds are borrowed from an associated party, the borrower needs to first establish that the amount borrowed is a bona fide debt (ie, follow the debt to equity test determined in the OECD Transfer Price Guidelines) and that the transaction is on an arm's length basis.

Further, where the funds are borrowed from a foreign entity, the interest payments would attract Non-Resident Withholding Taxes at a fixed rate of 10% on the gross amount of interest. In addition, this would have thin capitalisation implications as interest paid or payable to local financing institutions are fully deductible while foreign borrowings are deductible up to the thin capitalisation ceiling of 6% per annum.

5. Guarantees and Security

5.1 Assets and Forms of Security

The assets commonly made available as collateral to lenders include:

- first or second-ranking mortgage(s) over a borrower's real estate assets, including islands leased for tourism development and residential land;
- pledge(s) over the shares of the borrower or its subsidiaries;
- assignment of the borrower's bank accounts (over both the bank account balance and the banking account);
- assignment of insurance policies;
- assignment of proceeds or credit rights derived from income-producing agreements entered into by the borrower, such as hotel management agreements;
- personal guarantees by directors or shareholders; and
- sovereign guarantees by the government.

Mortgages over Tourist Resorts and Residential Land

Mortgages created over the leasehold rights of tourism developments would require prior approval from the Ministry of Tourism and subsequent registration with the Ministry after payment of a mortgage registration fee of MVR10,000. The approval and registration process generally takes five to seven working days per step.

Mortgages over residential land do not require prior approval, but there is a formal requirement to register the mortgage with the relevant authorities – ie, the city or local council, depending on the location of the residential land.

Share Pledge

With respect to pledges over shares of a borrower or its subsidiaries, there is no legal requirement for a share pledge to be registered in favour of the lender with any authorities in the Maldives. However, it is the general market practice for the same to be communicated to the Registrar of Companies, which maintains a record of the charges. This usually takes three to four working days, and no costs are involved.

Assignment of Bank Accounts and Insurance Policies

The general practice is for notice of assignment to be given to the respective banks in which the accounts are held and to the insurers from which the respective policies have been procured, and to obtain their signed acknowledgment as a condition subsequent to the completion of the transaction. The period in which this must be satisfied will be governed contractually. However, in recent financing transactions, local banks have been much more hesitant to allow the creation of a charge over bank accounts.

Sovereign Guarantees

The Public Finance Act (Law No 3/2006) regulates the provision of guarantees backed by the state or state-owned companies, or the mortgage of assets, rights or other interests held by the state, or the giving of undertakings and covenants affecting state assets or funds. This is with respect to loans or debt finance obtained by the state or by state-owned companies using the government as an intermediary, or with respect to transactions entered into on behalf of the state.

The Public Finance Act provides that such activities shall be carried out only after a proposal to do so is made by a Minister and approved by the President. Parliamentary consent by a simple majority of Members present and voting must be obtained.

5.2 Floating Charges and/or Similar Security Interests

Floating charges are commonly used in the Maldives, especially as project finance securities.

The crystallisation moment of such a charge generally occurs when the borrowing company defaults on its financial covenants or enters into insolvency.

5.3 Downstream, Upstream and Cross-Stream Guarantees

Entities in the Maldives are allowed to give downstream, upstream and cross-stream guarantees without restriction or limitation. There are therefore no issues relating to the adequacy of credit support in relation to these guarantees.

5.4 Restrictions on the Target

A target is restricted from granting guarantees, securities or financial assistance for the acquisition of its own shares. There are no limitations on the seller involved in an asset sale providing such guarantees, securities or financial assistance.

5.5 Other Restrictions

There is a requirement to obtain prior approval from the Ministry of Tourism where the leasehold rights to a tourism development are being mortgaged. No costs are incurred in obtaining this approval.

5.6 Release of Typical Forms of Security

Securities may be released upon the borrower fulfilling its obligations and/or the parties agreeing for the security to be released.

In the case of securities that are registered with the governmental authorities, the bank or the lender will execute a deed of discharge and communicate the same to the relevant authorities, which will then release the security from their records and communicate the discharge/de-registration in writing.

5.7 Rules Governing the Priority of Competing Security Interests

There are no specific statutes (such as insolvency laws) governing the priority of competing security interests in the Maldives. There is, however, an established practice whereby reference is generally made to Section 91 of the Companies Act to assume that the same order of settling debts (where the company enters a winding-up process) shall apply when a borrower goes into insolvency. In this regard, after paying the expenses incurred for winding up and remunerating the person(s) appointed to wind up the company, the assets of the company are to be used in the following order:

- money due to the government/government bodies;
- wages due to the employees of the company except directors for three months from the date the court issued the winding-up order or the company passed the special resolution to wind up the company; and
- the balance, if any, after settling the above, if not sufficient to discharge all debts of the company, shall be applied in satisfaction of the company's liabilities pari passu.

However, this means that, in a liquidation scenario, competing security interests may not have priority despite being perfected and registered with the authorities. It is ultimately a matter for a court to decide. Courts may take an approach that the security interest shall be ranked according to the time of creation or perfection.

In this regard, courts have followed the following ranking where such priority can be established through the contractual agreements of the debtor and creditors. Courts have also referred to the laws of developed jurisdiction to assist their assessment of the appropriate order to rank

debts. The commonly utilised ranking is as follows:

- first priority mortgages;
- fixed charges and secondary mortgages;
- floating charges; and
- unsecured debt (including judgment debts).

5.8 Priming Liens

Other than creditors' liens exercised over ships in Maldivian ports, liens do not arise by operation of law and need to be expressly created over assets. There are restrictions on the creation of liens over certain classes of assets. The only priming interest that may arise over securitised assets are ring fences over a company's assets in a liquidation process for debts owed to the government/tax authorities and a certain minimum amount (two months' pay) for employees being made redundant as a result of the liquidation.

No structure has been proven effective to go around the ring fences as courts are strict in implementing the ring fences in a liquidation process.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

A secured lender may enforce its collateral where there is an event of default under the underlying loan or security agreements.

The secured lender would have to file a claim at the Civil Court of Maldives to obtain a judgment debt against the borrower in default, through which they can request permission to sell the mortgaged asset.

Concerns to be taken into account are delays attributable to the court and any subsequent appeal processes, which may cause further delays in enforcing the collateral. Recent developments through case law indicate that the enforcement of an order (eg, for sale of a mortgage) shall not be stayed unless the appellate court issues a stay order on enforcement proceedings.

6.2 Foreign Law and Jurisdiction

Section 18(d) of the Contracts Act (Law No 4/1991) allows parties to decide on the governing law of the contract, whether it is foreign law or Maldivian law. It is common practice in the Maldives for loan and financing agreements to be governed under foreign law, especially in cross-border lending transactions.

The choice of foreign law as the governing law of a contract and a waiver of immunity will be upheld by the courts in the Maldives.

6.3 Foreign Court Judgments

Judgments delivered by a foreign court may now be directly recognised and enforced pursuant to the Maldives' Civil Procedure Code (CPC), which came into effect on 16 June 2022.

As per the CPC, courts are not allowed to decide on the merits of a foreign judgment applied for enforcement in the Maldives, but courts may look into the merits of the case to ensure the case is enforceable in the Maldives. A judgment delivered against a party by a foreign court shall only be recognised and enforced through Maldivian courts if the same judgment has legal effect and is enforceable in the country of origin of the judgment. The party opposing enforcement can raise an objection if the foreign judgment has been appealed in the country of origin or if the appeal period has not yet expired. A foreign judgment

is only enforceable if it complies with the laws of the Maldives and the fundamentals of Islam and satisfies one or more conditions in Section 391 of the CPC. The respondent to an enforcement application can contest the enforcement under Section 392 of the CPC. However, no request for enforcement of a foreign judgment has been filed in Maldivian courts to date.

Arbitral awards issued pursuant to a foreign-seated arbitration shall be recognised and enforced in the Maldives, without a retrial of the merits of the case, pursuant to section 72 of the Arbitration Act (Law No 10/2013) and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention), unless the award has been set aside in the courts of the seat or in the Maldives, or recognition of the arbitral award is refused by the High Court of the Maldives upon such an application being made.

6.4 A Foreign Lender's Ability to Enforce Its Rights

Save for any restrictions in the underlying loan or security agreement, there are no particular legal or regulatory provisions that may specifically impact a foreign lender's ability to enforce its respective rights.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

There are no insolvency laws in the Maldives.

However, assuming a similar procedure to the winding up of a company applies, where insolvency proceedings commence, the onus is on the lender to make a claim for the debt and prove the existence of such.

If the debt is secured and the securities can cover the value of the debt, there should not be any impediments on the lenders' rights to enforce their loans or security or guarantee, subject to the order of priority with respect to creditors.

7.2 Waterfall of Payments

Insolvency laws do not exist in the Maldives and, with reference to Section 91 of the Companies Act, after paying the expenses incurred for winding up and remunerating the person(s) appointed to wind up the company, the assets of the company are used in the order set in **5.7 Rules Governing the Priority of Competing Security Interests**.

One could argue that, according to this order, no priority is given to secured creditors over unsecured creditors and that they stand on an equal footing.

This is largely an untested area in Maldivian courts, which generally take a prudent approach in such instances and make reference to the laws of developed jurisdictions. In this regard, with reference to the insolvency laws applicable in other competent jurisdictions, the courts would most likely give priority to secured creditors over unsecured creditors. In terms of priority over securities, it is reasonable to assume that mortgages would rank first, followed by fixed charges and floating charges, in that order. The proceeds of a sale of a company's assets would only be paid to unsecured creditors (such as judgment debtors and trade creditors) after the debts to secured creditors are cleared.

7.3 Length of Insolvency Process and Recoveries

There is no specific insolvency law in the Maldives. Insolvency is dealt with through the limited proceedings under the Companies Act.

Under the Companies Act, a company can be dissolved in the following ways:

- voluntary dissolution by the company;
- by order of the court; or
- by decision of the Registrar of Companies to dissolve the company.

However, in a recent Supreme Court decision, the court took the view that a voluntary liquidation cannot be completed if there are creditors and it seemed to suggest that, where creditors are present, a court-administered liquidation route should be followed. The reasoning behind this view was however not clarified and it remains to be seen how this decision will be interpreted in similar cases moving forward.

Typically, the time for the completion of dissolution will be the same as any other case as there are no special provisions to govern such proceedings. In the event it is administered through court, it could take two to four years to go through all the courts.

Creditors such as banks can submit a joinder to be part of the process to ensure that, where assets are sold, creditors will be paid.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

In practice, companies are free to set internal procedures in relation to company rescues or reorganisations.

According to the Banking Act, the MMA shall appoint a conservator for a bank when it determines that:

- the bank has failed to pay its financial obligations as they fall due, including but not limited to deposit liabilities;
- the capital of the bank is less than 50% of the minimum capital required by the Banking Act or by regulation of the MMA issued pursuant to Chapter 4 of the Banking Act;
- a petition has been submitted for initiating bankruptcy proceedings against the bank; or
- the board of directors is unable or unwilling to properly manage the affairs of the bank.

Additionally, the MMA may appoint a conservator for a bank when it determines that:

- the bank has failed to carry out an order given to it by the MMA, including an order for payment of civil monetary penalties;
- the capital of the bank is too low to support safe and sound banking operations;
- there is evidence that the bank or any of its administrators have engaged in criminal activities punishable by imprisonment of one year or more, or there is evidence or reasonable cause to believe that the bank or any of its administrators is engaging in criminal activities; or
- there is reasonable cause to believe that the board of directors is unwilling or unable to properly manage the affairs of the bank.

The above provisions shall apply to the domestic branch offices and domestic representative offices in the Maldives of a foreign bank as if all these offices together were to form a single legal entity. All assets, liabilities, acts and omissions of the foreign bank resulting from or otherwise relating to the business of any such office shall be attributed to that single entity in applying the provisions. The conservator of a foreign bank shall be authorised to take all actions with respect to such foreign bank as could be taken by the authorised manager or by shareholders at the general meeting of shareholders of a domestic bank.

Parties are generally also free to enter into voluntary creditor arrangements to come to an agreement outside of insolvency proceedings. There have been instances where the government has also intervened to rescue or reorganise companies in which it is a stakeholder.

7.5 Risk Areas for Lenders

In the Maldives, laws on mortgages are limited, and the ranking of mortgages is clearly defined only for certain types of assets, such as freehold land, tourist assets, and vessels. In cases where there is no registration mechanism, the courts' approach remains uncertain.

Further, under the new Civil Procedure Code, with respect to the enforcement of mortgages both the lender and borrower must agree on the value of the mortgaged property in a foreclosure; failing this, both parties are required to agree on a third-party valuer. If this is not achieved, the judicial valuation committee must determine the value, which will form the minimum price for the process.

This requirement has complicated matters for lenders seeking to exercise their enforcement rights as it is rarely possible for the parties to agree on a value upfront and ultimately requires lenders to seek "approval" from the borrower in a foreclosure situation. If the case proceeds to the judicial valuation committee, it not only incurs additional delays, but the methodology employed by the committee to arrive at the valuation remains opaque, further complicating the enforcement process.

8. Project Finance

8.1 Recent Project Finance Activity

Project finance has been used in the Maldives for the past few decades, mostly for the financing of tourism development projects and government infrastructure projects. In 2023, there has been a rise in financing for solar projects undertaken by the government, power utility companies and private companies.

8.2 Public-Private Partnership Transactions

Since 2008, the government has made efforts to promote developmental projects, through public-private partnerships, especially infrastructure development projects. As such, an international airport project (the Malé International Airport) was tendered out on a public-private partnership basis and became the subject of political and social debate, which led to the public-private partnership being terminated by the following government; in turn, this resulted in a prolonged arbitration against the government, which the government ultimately lost.

Since then, the appetite for major public-private partnership projects has been low.

8.3 Governing Law

Section 18(d) of the Contracts Act (Law No 4/1991) allows parties to decide on the governing law of the contract, whether it is foreign law or Maldivian law. It is common practice in the Maldives for project documents to be governed under foreign law and for international arbitration to be used as the dispute resolution mechanism. Therefore, there is no restriction in the application of English or New York law or any other law for that matter to govern the project documents or the arbitration clause.

8.4 Foreign Ownership

Foreign entities cannot hold freehold rights over real property in the Maldives. This is a constitutional restriction. The workaround has been for the government to grant long-term leasehold interests which are, in all material respects (except for the lease term), akin to a freehold interest. All tourism assets are held as long-term leaseholds. Similarly, the government owns all real subsurface property rights, which are subject to the same long-term leasehold interests where it forms part of an asset in which the foreign entity invests.

8.5 Structuring Deals

There are no specific laws or restrictions that are relevant to project companies, although the primary consideration that needs to be made in structuring a deal may be tax-related.

In terms of foreign investment, the Foreign Direct Investment Policy reiterates the activities that are open for foreign investment, with the maximum foreign shareholding percentage and maximum period of investment that would be allowed for the activity, and the minimum investment requirement.

8.6 Common Financing Sources and Typical Structures

Typical financing sources include term loans from commercial banks or financial institutions. Project bonds have also gained momentum in the Maldives, with the government seeking additional financing to meet their working capital requirements.

8.7 Natural Resources

There are no oil and gas, power or mining sectors in the Maldives, so any acquisition or export in relation to these sectors is not regulated.

The acquisition and export of natural resources are governed under the respective environmental laws in the Maldives, with the Environmental Protection Agency regulating its compliance under the mandate issued to the Agency by the Ministry of Environment, Climate Change and Technology.

8.8 Environmental, Health and Safety Laws

The Environment Protection and Preservation Act (Law No 4/93) sets out the basic framework for environmental protection. The relevant ministry (now the Ministry of Environment, Climate Change and Technology) is mandated under this Act to further develop regulations and policies to ensure environment protection.

The Environment Protection Agency is a regulatory entity, affiliated with the Ministry, that is responsible for regulatory activities relating to the protection, conservation and management of the environment and biodiversity, as well as waste management and pollution prevention under the above-mentioned Act.

There are no laws on health and safety requirements that are applicable to projects. However, the Employment Act (Law No 2/2008) contains provisions on workplace safety and employee health, which shall apply to persons employed under the project. There are no mechanisms or procedures to oversee this, but employees may file a complaint with the Labour Relations Authority or Employment Tribunal for any breach of the general health and safety standards imposed under the Employment Act.

Trends and Developments

Contributed by:
Mohamed Shahdy Anwar, Zain Shaheed and Fathimath Lamaan
S&A Lawyers LLP

S&A Lawyers LLP is renowned for offering services in relation to the full spectrum of financial products, including lending and acquisition finance, asset finance and structured project finance. The firm acts for a diverse portfolio of clients, including international financial institutions, foreign and local banks and state-owned companies, and its lawyers are highly regarded for proposing dynamic solutions to complex financing transactions. The firm has advised leading banks from around the world on financial transactions relating to tourist resort and investment acquisitions in the Maldives, and has advised several foreign incoming investors new to the tourism and real estate market on almost all major inward investments in the sector.

Authors

Mohamed Shahdy Anwar is the managing partner and heads the corporate and commercial team at S&A Lawyers LLP. He is highly regarded in the market and has invaluable experience in private legal practice, advising various corporations and entities on a wide variety of corporate and commercial issues, including project financing for tourism and infrastructure projects; he also advises major international banks and financial institutions on lending for projects in the Maldives and abroad. Shahdy is highly regarded as a leading individual in the corporate and commercial field and has received many accolades and recognitions for his practice over the years. Shahdy was also recently appointed to the Board of Directors of the Maldives Monetary Authority which demonstrates his reputation and standing in the banking and financial sector in the Maldives.

Zain Shaheed is the head of the litigation and arbitration practice at S&A Lawyers LLP and handles contentious banking and finance matters. He began working in the City of London at the height of the financial crisis, where he was involved in landmark disputes relating to the LIBOR/TIBOR fixing scandal, the interest rate swaps scandal, and the subsequent implementation of voluntary remediation programmes of large financial institutions run by the Financial Conduct Authority of the United Kingdom. Zain has also advised large wealth fund managers, clearing houses, banks and other financial institutions in relation to disputes arising out of complex trust structures, CDOs, fx products and high-risk trading items such as indices and CFDs, in addition to advising on disputes relating to more conventional facilities.

Contributed by: Mohamed Shahdy Anwar, Zain Shaheed and Fathimath Lamaan, **S&A Lawyers LLP**

Fathimath Lamaan plays a leading role in the corporate and commercial team at S&A Lawyers LLP, with banking and finance being a key area of expertise. She has a wealth of experience in representing foreign real estate funds, investment firms and companies in acquisition deals relating to tourism, in addition to acting as local counsel for the related financing for such acquisitions. Lamaan has also acted for foreign banks and institutions on several cross-border financing and public offering deals, including the offering of high-value bonds by the Maldivian government and other state-owned companies.

S&A Lawyers LLP

#02-01 H. Millennia Tower
10 Ameer Ahmed Magu
Male' 20026
Republic of Maldives

Tel: +960 3013200
Email: info@sandalawyers.com
Web: www.sandalawyers.com

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The Maldivian Economy Shows Resilience

Despite grappling with the twin challenges of the COVID-19 pandemic and the Russia-Ukraine conflict, the Maldivian economy has shown resilience. Even with the cessation of flights from Russia, tourism has not only rebounded but now exceeds pre-pandemic levels. This revival is largely attributed to alternative markets like India and the Middle East compensating for the decline. Additionally, an influx of Chinese tourists, following the lifting of a more than two-year travel ban, has further bolstered the sector.

However, the Russia-Ukraine war has led to rising global energy and commodity prices, putting upward pressure on domestic inflation and negatively impacting the government's fiscal situation. Higher fiscal deficits are expected due to ambitious infrastructure investments by the government, coupled with blanket subsidies for energy and food, extensive capital outlays, and election-related expenditures.

To mitigate these challenges, the Maldivian authorities are in the process of establishing a legal framework for a Sovereign Development Fund. This framework aims to lay a robust legislative foundation for government-funded development projects while introducing strict governance, accountability, and reporting structures.

In light of these fiscal pressures, the World Bank has stressed the necessity for improved public investment planning and management to ensure macroeconomic stability. It has also underscored the need for economic diversification, advising the Maldives to reduce its reliance on tourism as the primary economic driver to mitigate the impact of external shocks. Moreover, the World Bank suggests that the significant presence of state-owned enterprises in the non-tourism sector hampers private sector development, indicating an area for potential reform.

In addition to the rise of inflation due to global constraints, in 2023 the Maldives government increased the rate of goods and services taxes from 6% to 8% for the general sector and from 12% to 16% for the tourism sector, with the aim of reducing the fiscal deficit. While the high public debt levels continue to be a concern, projections for the nation's economic growth are optimistic. According to the Maldives Monetary Authority and the Ministry of Finance, real GDP growth is expected to reach 9.4% in 2023. In contrast, the World Bank offers a more conservative estimate, projecting a real GDP growth of 6.6% for the same period. It remains to be seen which of these projections will materialise by year's end.

Continued Support for Small and Medium Businesses

At present, stakeholders continue to provide financial assistance to the local community, with a primary focus on aiding small and medium businesses (SMEs). The Small and Medium Enterprise Development Finance Corporation (SDFC), which falls under the purview of the Ministry of Economic Development, has reportedly disbursed loans totalling MVR1.7 billion (around USD110.2 million) in 2023 for SMEs. Their financial support primarily focuses on eight key sectors, which include local tourism, agriculture and fisheries.

Within the framework of the COVID-19 Business Assistance stimulus package, the corporation has sanctioned an additional MVR373 million in loans (around USD24.2 million), which have been allocated to 2,146 recipients. It was reported that the most substantial loans granted thus far range from MVR500,000 to MVR1 million (around USD32,400 to USD64,800).

Furthermore, the Maldivian government, recognising the vital importance of nurturing SMEs, has demonstrated its commitment to their growth and competitiveness. In June 2023, the government secured USD67.8 million from the World Bank. These funds are earmarked for various initiatives aimed at enhancing Maldives' digital financial ecosystem in order to make it more accessible for SMEs to obtain loans and streamline their financial operations effectively based on non-conventional performance metrics to assess creditworthiness, particularly for startups and SMEs.

In parallel, the Bank of Maldives has embarked on its mission to support SMEs by securing a USD41 million facility from the Asian Development Bank. This facility is dedicated to the same objective, namely, facilitating financing opportunities for small and medium enterprises. These co-ordinated efforts from both public and financial institutions underscore the government's recognition of the importance of nurturing SMEs and their commitment to the growth and competitiveness of startups and SMEs.

Developments in the Financial Sector

As the Maldivian economy gradually rebounds to pre-pandemic levels, the Bank of Maldives has taken steps in 2023 to ease certain restrictions that were put in place during the challenging period of the pandemic. One significant change is the removal of the previous USD cash withdrawal limit, which allowed customers to withdraw a maximum of USD2,000 per month. After nearly two years of this restriction being in effect, the bank has now increased the daily cash withdrawal limit to USD1,600. This adjustment reflects the bank's confidence in the improving economic conditions and the increasing need for flexibility in accessing funds.

However, while the withdrawal limits have been relaxed, the bank continues to maintain restrictions on foreign transactions. For international transfers and purchases made with credit cards linked to a Maldivian Rufiyaa account, the monthly limit remains at USD750. For debit card transactions under similar circumstances, the monthly limit stands at USD250. These measures are aimed at maintaining financial stability and ensuring responsible financial practices, particularly in cross-border transactions.

To modernise the financial landscape, the Maldives Monetary Authority, has introduced an innovative Instant Payment System called "Favara" in the Maldives. This system is designed to revolutionise the speed and convenience of money transfers for both individuals and businesses. Designed to be accessible through the respective banks' e-wallets, internet banking, and mobile banking applications, Favara allows users to swiftly transfer up to a maximum of MVR50,000 (around USD3,200) in a single transaction. Furthermore, Favara requests enable customers to conveniently request payments of up to MVR5,000 (around USD320) from other users, facilitating seamless financial interactions. As of the date of this publication, Bank of Maldives, Maldives Islamic Bank and the State Bank of India offer Favara payment services.

In line with these progressive initiatives, the Maldives Monetary Authority initiated a request for proposal for the drafting of an electronic Know Your Customer (e-KYC) regulation and related guidelines. The drafting of the regulation is believed to be underway, and the eventual implementation of this regulation will undoubtedly bring substantial benefits to the banking sector. It will streamline client onboarding processes, reduce the reliance on manual paper-

work, and enhance convenience and security for clients. Biometric authentication methods, such as facial recognition, would be welcome to mitigate fraud risks and ensure banks' compliance with regulatory requirements.

New Opportunities in the Market

In 2023, the liquidity status of the banking sector has remained adequate. Concerning the banks' lending activities, by the end of Q4 2022, the gross loans extended by these institutions had reached MVR33.1 billion (around USD2.1 billion). This marks a modest 2% quarterly increase and a more substantial 6% year-on-year increase. This growth in lending signalled that banks were actively involved in providing financial support to individuals and businesses, potentially contributing to economic expansion and entrepreneurship. In contrast, financing companies continued to excel in their performance during the same period. By the end of Q4 2022, these entities collectively managed total assets worth MVR4.2 billion (around USD272.3 million). This indicates a 5% quarterly and a 12% year-on-year growth rate.

However, despite these profitability gains, the rate of loan growth by local lenders still falls short of meeting the burgeoning demand in the Maldivian borrower market. This shortfall has led borrowers to increasingly turn to foreign lenders. The major foreign lenders for the tourism industry include Singaporean banks. Notably, a syndicate including DBS Bank and United Overseas Bank recently granted its first green loan in the Maldives for the development of several tourist resorts. The syndicate also included HSBC Singapore, which committed to their first green loan in the Maldives' hotel sector, having previously granted loans in other sectors. These developments signify a growing focus on sustainability among current investors in the Maldivian tourism sector. Key initiatives are being undertaken in areas such as sustainable architecture and renewable energy sources, and there could be more ESG loans on the horizon.

Although Sri Lankan banks previously used to play a key role in lending to private parties in the tourism sector, they have been absent in the market for quite some time now due to the ongoing recovery of their hard-hit economy. Stricter financial measures, such as an increase in the standard income tax rate from 24% to 30%, have been implemented in Sri Lanka, making it unlikely that these banks will re-enter the Maldivian lending market in the near future. However, some Sri Lankan banks are cautiously re-entering the market by negotiating debt restructuring options with borrowers.

Amid the ongoing presidential elections in the Maldives, the current government has taken a noteworthy step to address the severe housing crisis in the Greater Malé Region. A total of 6,200 plots of land were allocated to individuals just 62 days before the first round of elections, held on 9 September 2023. It is anticipated that the majority of these recipients will seek financing options for the construction and development of these housing plots. Consequently, new local schemes are expected to be rolled out, offering concessional loans to individuals to commence construction.

In a concerted effort to address climate change through renewable energy projects, the Maldivian government has ramped up solar projects in 2023. These initiatives are now seeing unprecedented interest from international investors. International bodies such as the Asian Development Bank and World Bank have already pledged financial support to help the govern-

ment attain its ambitious goal of achieving net-zero carbon emissions by 2030.

To broaden opportunities for foreign investors in the tourism sector, the Maldivian government has introduced several projects this year that qualify for cross-subsidies under the Cross Subsidy Regulation. The eligible projects include the development of several domestic and international airports in various atolls and the development of a residential city in Kaafu Atoll following dredging and reclamation of a lagoon. Applicants can apply for a 50-year lease on an island or lagoon to develop tourism establishments. This year, the government has already granted leases on several islands and lagoons, creating additional lending opportunities for foreign lenders. Amid this surge in tourism projects, construction activities, and solar energy initiatives, foreign lenders are likely to capitalise on the regulatory vacuum formed by the absence of cross-border lending regulations in the Maldives.

Conclusion

The Maldivian economy, while showing resilience, continues to be extremely vulnerable to unexpected external shocks. The Russia-Ukraine war and global economic volatility will likely continue to drive up commodity prices, putting additional pressure on the country's reserves and potentially increasing its already substantial external debt.

The significant upswing in housing and infrastructure projects in 2023, coupled with the acquisition of new tourism-related assets and the rapid expansion of solar initiatives by both government and private parties, has widened the spectrum of opportunities for foreign lenders. The granting of the first green loan for tourism development by a foreign lender this year will likely attract more foreign lenders interested in financing energy and sustainability projects.

While tourism has rebounded to pre-pandemic levels, global uncertainties loom large and demand vigilance from the Maldivian government. Due tothe impending change of government and the upcoming second round of presidential elections on 30 September 2023, the political climate is volatile, creating uncertainty for the banking and finance sector in the Maldives, and for the broader economy. The Maldives stands at a critical juncture. It is crucial to balance economic resilience with proactive risk management and robust fiscal reforms, not just to maintain the Maldives' economic standing, but also to shield against future vulnerabilities and risks.

MAURITIUS

Law and Practice

Contributed by:
Gilles Athaw, Jason Barbe and Anu Matikola
Bowmans

Contents

Bowmans is a leading African law firm with offices in Kenya, Mauritius, South Africa, Tanzania and Zambia, Alliance firms in Ethiopia and Nigeria, and special relationships with leading firms in Mozambique and Uganda. With over 500 lawyers, Bowmans delivers integrated legal services to clients throughout Africa from seven offices in five countries. Bowmans' advice uniquely blends expertise in the law, knowledge of local markets and an understanding of clients' businesses. The Mauritius office comprises of 17 experienced local practitioners who provide bespoke legal services. The firm specialises in corporate, private equity, banking and finance, securities and regulatory law, frequently advises on mergers and acquisitions and provides transactional support to investment funds and holding companies. It serves both local and international clients, including fund managers, private equity houses, management companies, banks, and financial institutions.

Authors

Gilles Athaw is a partner at Bowmans (Mauritius office) and heads the banking and finance practice. Having accumulated over 20 years' experience in the field of corporate and commercial law, as well as in banking and finance law, Gilles has advised a significant number of financial institutions and corporations, focusing mainly on cross-border financing, fintech and corporate structuring. He has an LLB (Hons) degree from the University of Buckingham and a Post Graduate Diploma in Law from the City University. Gilles also holds a certificate of competency in Cryptocurrency and Disruption from the London School of Economics.

Jason Barbe is an associate in the Mauritius office of Bowmans, where he acts for local and international clients on financing matters. He is specialised in drafting security documents in connection with cross-border financing. Prior to joining Bowmans, Jason gained experience in the Africa Practice department of CMS Francis Lefebvre Avocats in Paris, where he assisted clients in their project financing in francophone Africa (OHADA). Jason holds a Master II in Law (LLM) from the University of Paris XII and completed the Paris Bar Certificate at the Paris Bar School. Jason is a member of the Mauritius Bar and the Paris Bar.

Anu Matikola is an associate in Bowmans' Mauritius office. She is a corporate lawyer who also advises on banking and finance matters in the firm. She joined the team in October 2020. Prior to joining Bowmans, she worked at an attorney's office and thereafter at a reputed law firm in Mauritius, gaining a mix of experience in civil and litigation matters. Anu has a BA (Hons) in Finance, Accounting and Management from the University of Nottingham, a Post Graduate Diploma in Law and has completed the Bar Professional Training Course from Nottingham Trent University.

Bowmans

1st Floor, Court View Building
Pope Hennessy Street
Port Louis
Mauritius

Tel: +230 460 5960
Fax: +230 208 0605
Email: info-ma@bowmanslaw.com
Web: www.bowmanslaw.com

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1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Following the COVID-19 crisis of the past few last years and the delisting of Mauritius from the non-compliant jurisdictions list of international supervisory bodies, including the Financial Action Task Force (FATF), the Mauritian jurisdiction has experienced welcome stability during the year 2022–2023. However, due to rising inflation, new developments have emerged.

The Change in the Key Rate

On 11 January 2023, the Bank of Mauritius (BOM) informed the public of a new Monetary Policy Framework (MPF) effective from 16 January 2023, which replaces the former monetary policy framework set up in December 2006. The introduction of the new MPF is to address the deficiencies of the former framework in view of the constant changing economic and financial conditions and to enhance the monetary policy transmission mechanism and strengthen the effectiveness of monetary policy.

The new MPF seeks to, inter alia:

- keep relying on a key policy interest rate to maintain economic variables and expectations under control; and
- focus on key operational and strategic elements such as having a clearly defined and flexible inflation target.

The key policy rate pursuant to the new MPF will now be the "Key Rate", effectively replacing the "Key Repo Rate".

The most important impact on the loan market is the increase in the Key Rate (which has gone from 3% in the Key Repo Rate in September 2022 to 4.50% in June 2023). Due to the increase in the Key Rate, a growing interest has been noted for alternative funding by corporates which are seeking to raise finance or restructure their existing loans through the issue of high-yield corporate bonds, rather than traditional banking loans.

1.2 Impact of the Ukraine War

Inflation took a notable leap, surging from 4% in 2021 to a substantial 10.8% in 2022, marking the most remarkable surge in over a decade. This sharp rise has been primarily attributed to external supply shocks stemming from the conflict in Ukraine. These events triggered a chain reaction, leading to amplified prices in energy and essential food products. The impact on Mauritius was particularly noteworthy due to its status as a net importer of these goods.

The repercussions of this inflation surge, combined with the concurrent rise in interest rates, have made their presence felt in the local loan market. The effects were particularly pronounced among certain borrowers, and lenders found themselves in a position of having to renegotiate their existing loan agreements. This has prompted substantial discussions aimed at recalibrating the loan landscape. A significant aspect of these talks involves negotiating adjustments to the loan's tenure and repayment terms to better align with the new economic reality.

Against this backdrop, lenders are displaying a willingness to engage in these restructured arrangements. However, their co-operation is contingent upon a key condition involving the inclusion of new assets into the existing collateral pool, thus providing an additional layer of assurance for the lenders.

In essence, the recent economic shifts have set in motion a series of negotiations between borrowers and lenders, where the aim is to find a harmonious middle ground amidst the evolving financial landscape.

1.3 The High-Yield Market

The ability of corporates to raise finance by issuing high-yield corporate bonds has made them less reliant on banks for funding. Some corporates also leverage on high-yield bond structures to refinance existing bank loans via bond issuance.

The domestic bonds market has been very active recently. From an international perspective, Mauritius has also been a popular platform for the issuance of these types of instruments, either through Mauritian special-purpose vehicles or through foreign corporates listing their high-yield bonds on the Mauritian stock exchange.

1.4 Alternative Credit Providers

Peer-to-peer lending has proved very popular among start-ups and sole traders who seek microfinancing or financing of their working capital, supply chain or business expansion.

This platform has also gained an increased interest among lenders who are currently incentivised by benefiting from an 80% tax exemption on interest derived from a qualifying peer-to-peer lending platform.

Peer-to-peer lending and crowdfunding are still, however, in their infancy and require time for mass adoption. Consequently, despite their growing popularity, the volume of funds raised on peer-to-peer lending platforms is not significant enough to disrupt the traditional lending market, which remains the favoured financing route.

1.5 Banking and Finance Techniques

From a corporate lending perspective, a clear trend in more sophisticated lending structures has surfaced. Mezzanine financing and quasi-equity instruments are being used with the aim of creating long-term value for local projects.

Local banks have also showed robust participation in syndicated financing on local and outbound projects, as well as cross-border financing.

1.6 ESG/Sustainability-Linked Lending

Local banks have been partnering with several agencies to promote green loans at preferential interest rates and, by the same token, offering borrowers the possibility of receiving investment grants, depending on the specificities of their projects.

The government has also expressed its firm intention of decreasing its carbon footprint, by introducing several incentives for the financing of projects in the renewable energy sectors.

From a retail perspective, the acquisition of fast chargers for electric vehicles, rainwater-harvesting systems and photovoltaic systems for domestic use are fully tax-deductible. To make electric vehicles more accessible, hybrid and electric vehicles benefit from a reduced excise duty.

A guideline on Climate-related and Environmental Financial Risk Management has been published by the Bank of Mauritius and made effective as of 1 April 2022, with a view to assisting local financial institutions in embedding sound governance and risk management frameworks for climate-related and environmental financial risks within their existing risk management frameworks.

2. Authorisation

2.1 Providing Financing to a Company

Banks

According to the Banking Act 2004, no person is allowed to engage in banking business in Mauritius without a banking licence issued by the BOM.

Banking business is defined under the Banking Act 2004 as:

- the business of accepting sums of money, in the form of deposits or other funds, whether or not those deposits or funds involve the issue of securities or other obligations howsoever described, withdrawable or repayable on demand or after a fixed period or after notice; and
- the use of those deposits or funds, either in whole or in part, for:
  - (a) loans, advances or investments, on their own account and at the risk of the person carrying on that business;
  - (b) the business of acquiring, under an agreement with a person, an asset from a supplier for the purpose of letting out the asset to the person, subject to payment of instalments together with an option to retain ownership of the asset at the end of the contractual period;
- paying and collecting cheques drawn by or paid in by customers and making other payment instruments available to customers; and
- includes other such services as are incidental and necessary to banking.

Procedures

An applicant wishing to be authorised to operate as a bank must be a body corporate and must apply to the BOM using the prescribed form, accompanied by a non-refundable processing fee of MUR250,000 (approximately USD5,952). Among other AML, cybersecurity and related prescribed procedures and requirements, including the minimum capital adequacy ratio which the applicant needs to adhere to, the applicant must show adequate substance in Mauritius by having a principal place of business in Mauritius. In terms of staffing requirements, the applicant must have at least ten suitably qualified full-time officers, including the CEO, the Deputy CEO and key functional heads. The estimated operational costs of the applicant must not be less than MUR25 million (approximately USD595,200).

Non-banks

Moneylending activities are regulated by the Financial Services Commission of Mauritius. The Financial Services Act 2007 provides that, subject to certain exemptions as provided under the Fifth Schedule of the Financial Services Act 2007, any person, other than a bank or a non-bank deposit-taking institution, whose business is that of moneylending or who provides, advertises or holds themself out in any way as providing that business, whether or not they possess or own property or money derived from sources other than the lending of money, and whether or not they carry on the business as a principal or as an agent, is required to apply for a licence with the Financial Services Commission.

Procedures

An applicant wishing to be authorised to operate as a non-banking financial institution conducting moneylending activities must be a body corporate and must apply to the Financial Services Commission using the prescribed form, accompanied by a non-refundable processing fee, which varies depending on the type of licence being applied for. Among other AML, cybersecurity and related prescribed procedures and requirements, including the minimum paid-up

and unimpaired capital (normally around MUR50 million (approximately USD1,190,000)) that the applicant needs to adhere to, the applicant must show adequate substance in Mauritius by having a principal place of business in Mauritius and complying with other prescribed requirements.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

There is currently no restriction on foreign lenders to grant loans from their foreign jurisdiction. However, if those foreign lenders intend to carry on the business of moneylending in Mauritius, they should first obtain the appropriate licence from the Financial Services Commission or the Bank of Mauritius, depending on the activities that they wish to conduct.

3.2 Restrictions on Foreign Lenders Receiving Security

There are generally no rules restricting the granting of security or guarantees to foreign lenders in Mauritius. However, when a security involves the taking of a fixed and/or floating charge, certain elements as to the activities of the charge-holder will need to be considered.

Under the Mauritian Civil Code, a fixed and/or floating charge can only be granted in favour of an *Institution Agréée* (the Civil Code Restriction).

An *Institution Agréée* is, effectively, an approved institution, as listed in the *Institution Agréées* Regulations 1988, which lists those entities or category of entities approved to hold a fixed and/or floating charge, and include "any body corporate not registered in Mauritius and having no place of business in Mauritius".

Although the description of that approved body may appear broad, the Civil Code Restriction has been interpreted narrowly by the Supreme Court (vide Atelier Etude Limousin & others v BPCE International et Outremer & another 2014 SCJ 166).

Given this ruling, the prevailing market perspective has been that a foreign entity can reap the advantages of a fixed and/or floating charge only if it qualifies as a "financing institution". This stands in contrast to a scenario where the foreign entity might not be directly engaged in financing activities.

3.3 Restrictions and Controls on Foreign Currency Exchange

The Foreign Exchange Control Act was suspended in 1994. As a result, there is currently no exchange control requiring approval for payments outside Mauritius or repatriation of profits, dividends or capital gains earned in Mauritius.

3.4 Restrictions on the Borrower's Use of Proceeds

While Mauritian laws do not impose any legal constraints on how borrowers can utilise funds from loans or debt securities, it's common to observe contractual limitations on such usage. These limitations are typically established through mutual agreement between the lender and the borrower.

3.5 Agent and Trust Concepts

Mauritian laws acknowledge the notion of a trust. Additionally, the Civil Code offers broader concepts that can serve as substitutes for the trust including the *mandat* (which corresponds to agency) and the *tiers convenu* (where a third party is jointly appointed by the involved parties to hold the security).

It is a regular occurrence for domestic banks to be appointed as security agents acting on behalf of and for the benefit of foreign lenders when assets used as collateral are situated in Mauritius.

3.6 Loan Transfer Mechanisms

The most common loan transfer mechanisms include:

- loan assignments;
- debt consolidations;
- refinancing;
- loan sales or sell-down; and
- secondary market participation.

In bilateral financing, where the security is held directly by the lender, the security cannot be transferred without involving a prior release and the creation of a fresh security in favour of the new lender.

In certain circumstances, a security agent can be appointed to mitigate the impact of a loan transfer on the existing security.

3.7 Debt Buy-Back

The laws of Mauritius do not restrict a debt buy-back by the borrower or sponsor. However, it is recommended that the borrower or sponsor consider the appropriate structuring and address potential tax liabilities.

3.8 Public Acquisition Finance

There are no specific rules applicable to "certain funds" in respect of public acquisition finance transactions. However, when dealing with a potential takeover, the law requires that an offeror give a firm intention to acquire the target, containing confirmation by the board of the offeror that sufficient financial resources are available to satisfy the acceptance of the offer. Similarly, where the offer includes a non-cash consideration, the confirmation should provide that all reasonable measures have been taken to secure full payment of the shares acquired.

3.9 Recent Legal and Commercial Developments

The transition away from Libor has brought about changes in the existing facility documentation, which have necessitated certain adjustments to existing legal documentation.

3.10 Usury Laws

The concept of usury laws is not catered for by Mauritian laws. However, the Mauritian courts have the discretion to review downwards the interest amount if it is deemed excessive.

3.11 Disclosure Requirements

Except when a court order is issued directing the disclosure of such financial contracts, there are no rules and/or laws regarding the disclosure of financial contracts under Mauritian laws.

4. Tax

4.1 Withholding Tax

Withholding tax at a rate of 15% may apply on interest payable in certain circumstances.

However, there is no withholding tax for any payment made by a company holding a global business licence in Mauritius to lenders not carrying out business in Mauritius.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Value-added tax (VAT) is applicable at a flat rate of 15% to VAT-registered entities on all goods and services supplied by them in Mauritius, subject to certain supplies being exempted under

the Income Tax Act 1995 and the various income tax regulations.

Registration duty is payable on the registration of a document, either based on a proportional duty or as a fixed amount depending on the nature of the transaction witnessed by the document.

A Mauritian law-governed fixed and/or floating charge, mortgage and a bordereau pursuant to an assignment agreement are required to be registered (and inscribed for fixed and/or floating charges and mortgages), while registration of finance documents and security documents other than those aforementioned are at the option of the lender.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Some of the tax concerns will involve the following:

- withholding tax;
- transfer pricing;
- foreign exchange risks; and
- permanent establishment.

Withholding tax could be mitigated by optimising the use of existing tax treaties.

Transfer pricing risks could be mitigated by looking at the rates applied in comparable transactions or using the arms' length principle.

Foreign exchange risks could be mitigated by making use of currency hedging instruments or ensuring that the loan as well as the principal and interest repayments are made in the lender's currency.

Permanent Establishment risk could be mitigated by ensuring that the lender's activities in Mauritius do not create a permanent establishment.

5. Guarantees and Security

5.1 Assets and Forms of Security

The assets available as collateral to lenders in Mauritius consist of:

- shares;
- land/buildings (immovable property);
- contractual rights and receivables;
- bank accounts;
- intellectual property and other intangible and tangible rights;
- equipment/material, stocks and outillage (tools of trade);
- future assets; and
- business undertakings.

The common forms of security granted are as follows.

- Security over shares:
  - (a) a commercial pledge when the shares of a company that holds a licence issued by the Financial Services Commission are pledged in favour of a financial institution;
  - (b) a civil share pledge when the pledged shares relate to a domestic company; and
  - (c) a fixed and/or floating charge can also be granted as security over the shares.
- Security over land or building (immovable property):
  - (a) a mortgage under the Mauritian Civil Code; and
  - (b) a fixed and/or floating charge.
- Security over contractual rights and/or receivables:

(a) an assignment of contractual rights and/or receivables by way of security; and
(b) a pledge under the Mauritian Code de Commerce.

- Security over bank accounts:
  (a) pledge under the Commercial Code; and
  (b) a fixed and/or floating charge.
- Security over intellectual property and other intangible and tangible rights:
  (a) an assignment of rights by way of security; and
  (b) a fixed and/or floating charge.
- Security over equipment/material, outillage (tools of trade) and stocks are:
  (a) a special pledge under the Mauritian Civil Code; and
  (b) a fixed and/or floating charge.
- Security over future assets:
  (a) a pledge or an assignment by way of security under the Commercial Code; and
  (b) a floating charge.
- Security over a business undertaking (fonds de commerce): a pledge of the business undertaking.

Perfection Requirements

A share pledge

In addition to the execution of the share pledge, the pledgor is required to procure the delivery of the following to the pledgee:

- a signed and undated blank share transfer form;
- share certificates or other instruments evidencing or representing the pledged shares; and
- a transfer-in-guarantee instrument signed by the pledgee, the pledgor and the secretary of the company in which the shares are being pledged in respect of the pledged shares.

Fixed and/or floating charge

The fixed and/or floating charge agreement is required to be prepared in a prescribed format and must be registered with the Registrar General and inscribed with the Conservator of Mortgages of Mauritius.

A memorandum setting out details of the charge must be affixed to the deed prior to the inscription. The chargor must deliver the registered deed of fixed and/or floating charge and provide satisfactory evidence of registration and inscription to the secured party.

Mortgage

The deed of mortgage, with the requisite memorandum (bordereau) annexed, must be inscribed in the registers of the Conservator of Mortgages.

Assignment under the Commercial Code

A memorandum, known as a bordereau, which witnesses the assignment and forms part of the perfection requirement thereof under the Commercial Code, must be executed by the assignor and must be registered in the interest of the assignee with the Registrar General. The registered bordereau must thereafter be delivered to the assignee by the assignor.

Account pledge

A notice of pledge must be sent to the account bank.

Pledge of business undertaking (fonds de commerce)

The pledge of business undertaking is created under a deed prepared by a notary public or a deed under private signature and must be registered with the Registrar General of Mauritius. The registration with the Registrar General must be made within 15 days of the signing date of the pledge agreement.

Timing and Costs Involved

Depending on the type of entity involved, registration must be effected within eight days or up to three months for companies holding a global business licence (except for the pledge of business undertaking which must be registered within 15 days from the date of the security document). The registration process takes around three business days to complete. Registration duty and administrative fees (formerly stamp duty) payable to the Registrar General, amount to around MUR50,700 (approximately USD1,200) per document. Inscription of charges would also incur an additional inscription fee of around MUR1000 (approximately USD23).

5.2 Floating Charges and/or Similar Security Interests

The Mauritian Civil Code allows for the creation of a floating charge over all present and future assets of a company as security.

5.3 Downstream, Upstream and Cross-Stream Guarantees

Downstream, upstream and cross-stream guarantees are generally permitted. This type of security is generally granted by way of a corporate guarantee, as provided under the Mauritian Civil Code. However, giving such a guarantee could be restricted where it amounts to providing financial assistance.

5.4 Restrictions on the Target

The laws of Mauritius restrict a target from providing a loan or guarantee or any form of security where the purpose of such a loan, guarantee or security is for the acquisition of the target's own shares. In these circumstances, specific conditions must be adhered to by the target before it is permitted to provide any such financial assistance.

5.5 Other Restrictions

Except for the aforementioned restrictions, there are generally no other restrictions in connection with, or significant costs associated with, or consents required to approve, the grant of security or guarantees.

5.6 Release of Typical Forms of Security

A security is generally released only when the secured obligation has been paid in full and all facilities which gave rise to the secured obligation have been terminated. However, when dealing with the release of mortgages and fixed and/or floating charges, an additional procedure is required to ensure that the security is erased from the public registers of the Conservator of Mortgages. The erasure is formalised by a letter from the secured party to the Conservator of Mortgages confirming the discharge of the secured obligation, the release of the security and requesting the erasure of the security from the registers of the Conservator of Mortgages.

In respect of pledges and assignments, the secured party is required to return all documents delivered to it at the time of perfection of the security (which include share certificates, blank transfer forms or, in some instances, the bordereau), and counterparties will update their internal records to reflect the discharge and release.

By way of exception, the parties can also mutually agree to release the security before the discharge of the secured obligation. This can be done by way of a release agreement entered into between the parties providing for the release of the security. The same procedures as discussed above will apply for the release of that security.

5.7 Rules Governing the Priority of Competing Security Interests

In the event of insolvency, the Mauritian Insolvency Act 2009 provides the following ranking of claims of preferential creditors:

- cost of the liquidator;
- costs of compromises by the company with its creditors under the Companies Act;
- payments made pari passu with first-ranking fixed and floating charges and mortgages inscribed for more than three years;
- first-ranking fixed and floating charges and mortgages inscribed for less than three years;
- other secured creditors; and
- all other unsecured creditors who have been proved in the bankruptcy or winding-up.

When competing security interests arise, they are treated equally unless the lenders and the same borrower contractually vary their priority over the security by way of a subordination or intercreditor agreement. The subordination or intercreditor agreement will generally provide that the junior lender will not receive payments from the borrower until the senior lender has been paid.

The contractual provisions of a Mauritian law-governed subordination agreement will survive the insolvency of the borrower and will be recognised and given right in an insolvency procedure.

5.8 Priming Liens

Under the laws of Mauritius, the most material security interests that arise by operation of law are special liens. These special liens confer a right on a creditor to be preferred above other creditors, including creditors under a mortgage deed. The most material special lien is the one which is granted to any bank established in accordance with the provisions of the Banking Act. Following a loan, an advance, or other banking facility provided by the bank, a special lien will be granted to the bank on the sum standing to the credit of all accounts of the borrower.

Another special lien that arises by operation of law is the special lien granted to the seller of an immovable property, and which will secure the outstanding payment to be effected by the buyer.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

The circumstances for a secured lender to enforce a security will depend on the contractual provisions of the financing and security documents and on the type of security granted to the lender. In general, an event of default must have occurred under the finance and security documents, which will trigger the enforcement of the security.

Enforcement of a Fixed Charge

A secured lender can enforce a fixed charge that it holds over assets by appointing a public or private registered usher to seize the assets, without the need to serve a *commandement* (notice) on the debtor. If the debt remains unpaid, for three weeks following the date of seizure, the creditor can then sell the seized assets by public auction (in the case of movable assets), or by serving a notice in the same manner previously described (in the case of immovable assets).

Enforcement of a Floating Charge

The floating charge must first be converted into a fixed charge. This is known as the crystallisation of the floating charge. This requires the appointment of a court usher to draw a memorandum of

inventory, which will then be transmitted to the Conservator of Mortgages to be inscribed in its registers, whereupon the charge is converted to a fixed charge. This process may entail further costs in terms of taxes or fees.

Enforcement of a Special Civil Pledge Over Shares

The bank must serve notice on the debtor, stating its intention to proceed with the transfer of the pledged shares. The bank can then cause the pledged shares to be transferred seven days after the notice is served.

Enforcement of a Pledge of Shares Under the Commercial Code

The pledgee must realise the pledged shares by completing and executing the share transfer form. No other formalities are required.

Enforcement of Mortgages

The creditor can enforce a mortgage by serving the debtor a *commandement* (notice) notifying the debtor that, if it fails to pay the amount claimed, a seizure will be effected on the mortgaged property. The service of the *commandement* is effected through a public or private registered usher. The seizure of the mortgaged asset cannot be effected until at least ten days have elapsed since the date on which the *commandement* was served. The usher will then draw up a memorandum of seizure that must be registered and transcribed with the Conservator of Mortgages/Registrar General of Mauritius. A creditor enforcing a mortgage must also register and transcribe a memorandum of charges with the Conservator of Mortgages/Registrar General of Mauritius, containing the desired conditions of sale. The property may then be seized and sold, before the Supreme Court of Mauritius, to the highest bidder.

6.2 Foreign Law and Jurisdiction

The choice of a foreign law as the governing law of the contract will be upheld in Mauritius.

6.3 Foreign Court Judgments

A foreign judgment or arbitral award against a Mauritian company will be enforceable in Mauritius without a retrial of the merits of the case, subject to fulfilling the necessary exequatur procedures to recognise that foreign judgment or arbitral award.

6.4 A Foreign Lender's Ability to Enforce Its Rights

When a foreign lender does not own any immovable property in Mauritius, the debtor (as defendant) can apply for an order for the foreign lender (as plaintiff) to provide security for its costs before proceeding further with any claim in court.

Where the security involves immovable property in Mauritius, the foreign lender will require approval of the Prime Minister's office if it were to transfer title of that property in its own name.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

The facility agreement will generally treat an insolvency event as an event of default and will usually include mechanisms where, upon the occurrence of such an event, the lender may have recourse to claim repayment of the loan and to enforce the security or guarantee which was provided to secure the loan.

The lender may appoint a receiver to secure all the assets provided as collateral to avoid disposal by the grantor.

In certain circumstances, a company may begin administration procedures under the Insolvency Act 2009. During the time that a company is in administration and upon the appointment of an administrator, a lender cannot enforce a charge on the property of the company except with the written consent of the administrator or with the permission of the court and on terms that the court thinks appropriate.

This restriction, however, does not apply to a secured creditor; ie, a person who holds a charge on or over the property of the company and includes the holder of a "gage". The secured creditor may apply to the court for an order granting leave to them to enforce their security within a specified period after the company has been put into administration.

The restriction does not further apply to those secured creditors who have already taken steps to enforce their rights to recover the property before the beginning of the administration of the company.

7.2 Waterfall of Payments

The Insolvency Act 2009 sets out the order of priority in which creditors are paid on a company's insolvency. The order of priority is as follows:

- first, the liquidator or receiver for their fees and expenses and any indemnity to which they are entitled from the property of the company;
- second, costs of compromises by the company with its creditors under the Companies Act;
- third, payments made pari passu with first-ranking fixed and floating charges and mortgages inscribed for more than three years;
- fourth, first-ranking fixed and floating charges and mortgages inscribed for less than three years;
- fifth, other secured creditors; and
- sixth, all other unsecured creditors who have been proved in the bankruptcy or winding-up.

7.3 Length of Insolvency Process and Recoveries

The Insolvency Act 2009, which is the principal legislation dealing with the insolvency of companies, sets out the typical insolvency procedures in view of enabling the creditors to recover their debt, which are the receivership procedure and the liquidation procedure.

Under the receivership, a receiver will be appointed by a secured creditor to take control and possession of the property in receivership (i) to protect the secured creditor's position and (ii) to manage or realise the asset for repayment of the debt to the secured creditor. The Insolvency Act 2009 does not provide for any prescribed period of time for the completion of the receivership process. The length of the receivership procedure would generally take eight months to 16 months to complete but it may take longer if the affairs of the company are more complex.

Under the liquidation process, a liquidator will be appointed to take possession of, protect, realise and distribute the assets, or the proceeds derived from the realisation of the assets. Similarly for the receivership procedure, the Insolvency Act 2009 does not provide for any prescribed period of time for the completion of the liquidation process. The length of the liquidation process would generally take 12 months to 18 months to complete but may take longer if the transaction is more complex.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

The Insolvency Act 2009 also sets out the formal mechanism for the rescue or reorganisation of a company, which is the voluntary administration of a company.

The aim of a voluntary administration is to enable a business, property and affairs of a company to be administered in a way (i) to provide an opportunity for the company and its business to continue to exist or, should the former scenario not be possible, (ii) to provide a better return for the company's creditors and shareholders, compared to an immediate winding-up of the company.

The administrator may be appointed by the company in administration, by a secured creditor holding a charge over the whole/substantially the whole of the company's property or a buy-order of the court.

The Mauritius Companies Act 2001 further provides other mechanisms for company rescue, which include:

- a compromise between the company and its creditors;
- amalgamation procedures; and
- a scheme of arrangement by a creditor or a shareholder in relation to the company.

7.5 Risk Areas for Lenders

Potential risk areas which the lender may face, upon a borrower, security provider or guarantor becoming insolvent, are as follows.

Voidable Preference

A voidable preference is a transaction which involves creating a charge over the debtor's property and incurring an obligation, and which (i) has been entered into by the company as a debtor at a time when the company is unable to pay its due debts and which (ii) enables another person to receive more towards satisfaction of a debt by the company than that person would receive in the bankruptcy or liquidation. A voidable preference, which was made within two years immediately before adjudication or commencement of the winding-up, may be set aside by the court upon application by an official receiver or a liquidator making such an application.

Voidable Charge

A charge over a property or undertaking of a debtor, given within two years before the debtor's adjudication or the commencement of the winding-up and where, immediately after the charge was given, the debtor was unable to pay its due debts, may be set aside by the court upon the application by an official receiver or a liquidator.

8. Project Finance

8.1 Recent Project Finance Activity

Energy

The governments' push for cleaner energy sources and the need to update or expand energy infrastructure have driven considerable investment in these projects. The main projects involve medium-sized to large-scale solar farms and wind farms.

Infrastructure

Large-scale infrastructure projects like roads, bridges and public transportation with the latest light railway system have been the main projects in this category.

Real Estate Development

Large real estate development projects, such as smart cities involving commercial complexes, residential communities, and tourism are driving projects in this specific sector.

8.2 Public-Private Partnership Transactions

The Mauritian government has promulgated the Public-Private Partnership Act 2004, which came into force on 1 March 2005 (the "PPP Act").

The PPP Act provides for the implementation of PPP agreements between contracting authorities and private parties and establishes a set of rules governing public-private procurement.

Over the years, the main PPP projects have involved the energy sector, with the setting up of various power plants using fossil fuel and renewable sources, the development of the freeport zone and airport terminal, the setting-up of a waste-water treatment plant and road infrastructure projects.

There are currently ten active projects in the country, with active investments exceeding USD940 million.

8.3 Governing Law

Project documents are not required to be governed by local law, nor are disputes required to be resolved in local courts. The choice of a foreign law, as the governing law of the contract, will be upheld in Mauritius. Likewise, the choice of a foreign jurisdiction or international arbitration for settlement of disputes will be recognised.

8.4 Foreign Ownership

Foreign entities (or any Mauritian company with a non-citizen of Mauritius as shareholder or ultimate beneficial owner) must seek approval of the Prime Minister Office if they intend to acquire immovable property within Mauritius.

Likewise, if a foreign lender intends to enforce any remedial rights on a security related to immovable property in Mauritius, leading to an eventual ownership of that said property, obtaining the Prime Minister Office's approval will be a prerequisite.

8.5 Structuring Deals

The ownership structure is the primary concern for a project – the type of vehicle used and how it is organised to "house" the investors and financiers. Traditionally, a private company limited by shares would be the favoured option, but other structures may be more appropriate, depending on the type of project.

Where immovable property would be owned or leased over a period by the project vehicle, approval from the Prime Minister's office would be required if non-citizens would be holding a direct or indirect shareholding or interest in the project company, except where certain exemptions are provided.

The financial structure would also be of relevance in determining how the project would be financed, which could involve equity, short-term and long-term loans, bonds (listed or unlisted), quasi-equity and the determination of the relevant revenue streams to service the debts. Each type of financing would require specific attention in order to comply with the regulatory environment.

8.6 Common Financing Sources and Typical Structures

The financing sources and structures can vary depending on the nature of the project, its scale,

and the risk profile. The typical financing sources and structures would include:

- bank financing – with fixed or variable interest rates and repayment terms tailored to the project's revenue generation;
- export credit agency (ECA) financing – particularly common in large infrastructure projects; and
- project bonds – generally issued by project companies to investors seeking long-term, fixed-income instruments.

Alternative sources of financing include:

- private equity – private equity firms may invest directly in projects in exchange for equity ownership seeking higher returns being more actively involved in project management and decision-making;
- public-private partnerships (PPPs) – private entities often finance or provide land for the development of a specific project. They may also design, build, operate and maintain the project over a defined period;
- multilateral and development banks – international institutions like the World Bank, Asian Development Bank and African Development Bank provide funding and support for development projects in emerging markets, including Mauritius; and
- crowdfunding and peer-to-peer lending – while not very common for project financing in Mauritius, smaller projects might use crowdfunding or peer-to-peer lending platforms to raise capital from a large number of individual investors.

8.7 Natural Resources

Mauritius does not have extractive natural resources and exportation is not an issue.

8.8 Environmental, Health and Safety Laws

The Environment Protection Act stands as the main legal framework governing matters of the environment concerning various projects. It mandates that project promoters undertake the task of preparing either an Environmental Impact Assessment (EIA) or a Preliminary Environmental Report (PER), depending on the specific context. Subsequently, they are required to secure the relevant EIA Licence or PER Licence, subject to conditions stipulated by the regulatory authority.

Shouldering the responsibility of overseeing these processes is the Environmental Assessment Division within the Ministry of Environment, Solid Waste Management, and Climate Control. This division plays a crucial role in the early stages of project initiation by pinpointing potential environmental repercussions linked to significant undertakings. It takes charge of addressing any emerging concerns right from the project's outset. Additionally, this division ensures that effective measures are implemented to counteract unfavourable environmental impacts while also fostering positive outcomes. The overarching aim is to drive sustainable development.

It's within the mandate of this division to issue both EIA Licences and PER Licences – pivotal documents that underscore a project's compliance with environmental prerequisites.

Trends and Developments

Contributed by:
Gilles Athaw
Bowmans

Bowmans is a leading African law firm with offices in Kenya, Mauritius, South Africa, Tanzania and Zambia, Alliance firms in Ethiopia and Nigeria, and special relationships with leading firms in Mozambique and Uganda. With over 500 lawyers, Bowmans delivers integrated legal services to clients throughout Africa from seven offices in five countries. Bowmans' advice uniquely blends expertise in the law, knowledge of local markets and an understanding of clients' businesses. The Mauritius office comprises of 17 experienced local practitioners who provide bespoke legal services. The firm specialises in corporate, private equity, banking and finance, securities and regulatory law, frequently advises on mergers and acquisitions and provides transactional support to investment funds and holding companies. It serves both local and international clients, including fund managers, private equity houses, management companies, banks, and financial institutions.

Author

Gilles Athaw is a partner at Bowmans (Mauritius office) and heads the banking and finance practice. Having accumulated over 20 years' experience in the field of corporate and commercial law, as well as in banking and finance law, Gilles has advised a significant number of financial institutions and corporations, focusing mainly on cross-border financing, fintech and corporate structuring. He has an LLB (Hons) degree from the University of Buckingham and a Post Graduate Diploma in Law from the City University. Gilles also holds a certificate of competency in Cryptocurrency and Disruption from the London School of Economics.

Contributed by: Gilles Athaw, **Bowmans**

Bowmans

1st Floor
Court View Building
Pope Hennessy Street
Port Louis
Mauritius

Tel: +230 460 5960
Email: Info-ma@bowmanslaw.com
Web: www.bowmanslaw.com

Introduction

Within the picturesque island nation of Mauritius, the financial landscape is undergoing a series of transformative shifts that mirror the country's commitment to embracing innovation while upholding stability. This article delves into the latest trends and significant developments that have emerged within Mauritius' financial sphere over 2023. From the recalibration of monetary policy frameworks to the upcoming advent of digital currencies and the meticulous regulation of fintech entities, these trends encapsulate the country's proactive stance in navigating the ever-changing currents of modern finance. Against the backdrop of its unique socio-economic fabric, Mauritius exemplifies the fusion of tradition and progress, making it a compelling case study in the global evolution of financial systems.

Central Bank Digital Currency

The Bank of Mauritius (Central Bank) has embarked on an impactful journey, marked by the release of a public consultation paper that sheds light on the issuance of a transformative Central Bank Digital Currency (CBDC) named the Digital Rupee. This strategic initiative aspires to furnish the populace with a secure, convenient and seamlessly integrated digital version of the national currency. The Central Bank's discerning approach, cultivated since the project's inception in 2020, has been underscored by a judicious examination of CBDC's potential benefits and the meticulous crafting of the Digital Rupee's framework.

To ensure the Digital Rupee's optimal realisation, the Central Bank has sought the invaluable technical expertise of the International Monetary Fund (IMF), setting a remarkable precedent as the pioneer recipient of such collaboration among central banks. In addition, the Central Bank has tapped into insights offered by peer central banks and esteemed international organisations, collectively dedicated to advancing the landscape of digital currency.

During the IMF/World Bank Community of Central Bank Technologists workshop on the theme "The Future of Central Bank Money in a Digital World" held on 26 April 2023, the Governor of the Central Bank, Mr Seegolam, revealed the vision of initiating a pilot phase for the Digital Rupee. This transformative stride is set to unfold in November 2023 following a meticulous sandboxing exercise and the finalisation of the Digital Rupee's design attributes.

A public consultation paper titled "Central Bank Digital Currency: The Digital Rupee", was issued on 2 June 2023, with the underlying core motive being the collection of public sentiments concerning the potential introduction of the Digital Rupee. The valuable insights gathered through this process will play an instrumental role in shaping the contours of this pioneering initiative.

The CBDC uncovers a digital embodiment of a nation's traditional banknotes and coins, which will take the form of the Digital Rupee. Unlike crypto assets, the Digital Rupee will not assume the volatility characteristic of cryptocurrencies; its value will remain as steadfast and reliable as the physical currency.

In the realm of technological evolution, marked by phenomena like the Internet of Things and Artificial Intelligence, customer-business interactions and transactions are undergoing a paradigm shift. The Central Bank perceives the evolving payment landscape, with digital transactions assuming an augmented role, necessitating its proactive adaptation to this dynamic milieu. The introduction of the Digital Rupee, as a retail CBDC, is poised to unlock innovative avenues for commercial banks to deliver enhanced services and broaden the scope of payment options.

As we contemplate the roadmap ahead, it's discernible that the Central Bank's proposed CBDC will complement rather than replace traditional cash. Physical banknotes and coins will continue to be available, co-existing seamlessly with the Digital Rupee. While design features for the CBDC are yet to be definitively established, the Central Bank contemplates a distribution model in which commercial banks serve as conduits for providing the Digital Rupee to end-users, mirroring the existing distribution of physical currency.

The narrative culminates in a spotlight on the considerations enveloping the CBDC landscape. Pivotal to this is the Central Bank's commitment to affording universal access to the Digital Rupee, thereby empowering every citizen. A meticulous distribution model, wherein commercial banks act as intermediaries, preserves user transaction privacy. As the Central Bank forges ahead, its design ethos envisions a Digital Rupee that transcends mere transactional currency to encompass offline capabilities, seamless accessibility, and 24/7 availability.

The journey to digital currency integration, as painted by the Bank of Mauritius, promises to redefine the nation's economic landscape. The issuance of the Digital Rupee stands as a testament to the Central Bank's commitment to innovation, prudence and inclusivity, fostering a financial ecosystem poised for the digital age.

The public, industries and stakeholders were invited to contribute their insights and suggestions regarding the potential introduction of the Digital Rupee in Mauritius. This collective wisdom will be harnessed to shape the course of this pioneering initiative. As the Central Bank invokes the power of participatory collaboration, it pledged to use the feedback received to enrich the CBDC's journey, all the while respecting the anonymity of contributors.

The Draft Securitisation Bill Issued by the Financing Services Commission for Public Consultation

The Securitisation Bill was issued in March 2023 for public consultation and is poised to establish a comprehensive regulatory framework for the securitisation of receivables originating from financial institutions. It meticulously defines key terms, ensuring a shared understanding throughout the Bill.

The Bill outlines the necessary steps for corporations seeking registration as securitisation vehicles under the oversight of the Financial Services Commission (FSC). These requirements include submitting a business plan, identity documents for key personnel, and other relevant information. A minimum capital requirement is also established to emphasise the importance of financial stability.

The legislation further establishes guidelines for the proper transfer of receivables, ensuring full compliance with its regulations. It underlines the legal binding of such transfers, thus safeguarding the interests of both originators and securitisation vehicles.

Responsibilities assigned to originators within the securitisation process are clearly defined to ensure the avoidance of conflicts of interest and the upholding of ethical practices, thereby maintaining the industry's integrity.

Supervisory measures and powers are introduced to uphold the industry's stability and credibility. These measures empower the Chief Executive of the FSC with the authority to suspend a securitisation vehicle's registration in cases where industry integrity is compromised. Additionally, the Chief Executive is granted the ability to issue directions to enforce compliance with the Act's stipulations and associated rules.

Throughout the Bill, careful attention is given to explaining complex terms, fostering a comprehensive understanding of the securitisation process. Such terms as "credit enhancement", "securitisation position", and "risk retention" are elaborated upon, aiding in their comprehension within the Bill's context.

The legislation highlights transparency's significance, necessitating thorough disclosures by securitisation vehicles to potential investors. This commitment to informed decision-making and investor protection is consistently underscored.

The Draft Securitisation Bill represents a comprehensive and coherent framework for regulating the securitisation of financial institution-originated receivables. The Bill aims to foster integrity, transparency and investor confidence within the securitisation process. Should it be enacted, this legislation could stand as a pivotal tool for guiding and overseeing the securitisation landscape within the financial sector.

Draft Fintech Service Provider Rules Unveiled by the Financial Services Commission for Public Consultation

In a groundbreaking move towards enhancing the financial landscape, the Financial Services Commission has issued a draft of the Financial Services (Fintech Service Provider) Rules 2023 for public consultation. These rules usher in a new era of governance for fintech entities, ensuring they operate with utmost efficiency, security and transparency. This article delves into the key provisions of these rules, shedding light on the stringent criteria and comprehensive guidelines that fintech service providers must adhere to.

The Financial Services (Fintech Service Provider) Rules 2023 are set to transform the fintech landscape by imposing rigorous standards on entities that provide fintech-enabled services. These services, as outlined in the Schedule, range from anti-money laundering solutions to decentralised ledger technology, reflecting the diverse innovations driving the financial sector.

To provide fintech-enabled services in Mauritius, entities are required to hold a Fintech Service Provider Licence issued by the Commission. This pivotal step underscores the Commission's commitment to ensuring that only qualified and competent players participate in the fintech arena. The criteria for application are precise – applicants must be either companies incorporated under the Companies Act or foreign companies registered in Mauritius.

Aiming to bolster financial stability, the rules stipulate that Fintech Service Providers maintain a minimum unimpaired stated capital of MUR600,000 or its equivalent in any other currency. Moreover, a subscription to a professional indemnity insurance policy of no less than MUR2 million is mandated, mitigating risks arising from errors or omissions.

The rules emphasise the paramount significance of effective governance and risk management structures. Fintech Service Providers are expected to maintain a board of directors comprising at least three directors, one of whom must be a resident of Mauritius. These boards are entrusted with overseeing the entity's activities and ensuring alignment with principles of corporate governance and risk mitigation.

Recognising the integral role of technology, the rules require Fintech Service Providers to uphold stringent information technology measures. These measures encompass the resilience of systems, safeguarding against unauthorised access, and preserving data integrity. An annual review of these measures and third-party audits ensure that technological security remains a steadfast priority.

In an age marked by heightened concerns about data breaches, the rules underscore the importance of robust data security protocols. Fintech Service Providers are mandated to implement stringent safeguards for personal and financial data. This includes compliance with relevant Data Protection laws in Mauritius, thereby ensuring client information remains confidential and protected.

Transparency lies at the core of the fintech evolution. Fintech Service Providers are required to provide comprehensive and accurate information about their services, emphasising associated risks. This transparent approach ensures that clients can make informed decisions aligned with their needs.

The Financial Services (Fintech Service Provider) Rules 2023 are a resolute step towards moulding a modern and secure financial landscape. By enforcing stringent standards across various facets of fintech operations, these rules inspire confidence in investors, clients and stakeholders. Through the symbiotic partnership between technological innovation and regulatory vigilance, Mauritius propels itself as a global hub for fintech excellence, embracing the future while safeguarding against potential risks. As these rules come into effect, the realm of financial services stands poised to embark on an exciting and transformative journey.

Guidance Notes on Stablecoins Issued by the Financial Services Commission

The emergence and rapid adoption of stablecoins in the virtual asset landscape have prompted the Financial Services Commission of Mauritius to issue a comprehensive guidance note on their regulatory treatment. As a critical component of the evolving financial ecosystem, stablecoins require precise categorisation and robust regulatory oversight to mitigate potential risks and ensure investor protection. The key

aspects of the guidance notes issued on 24 July 2023, shed light on the classification, regulatory treatment and investor precautions pertaining to stablecoins.

Stablecoins, a subset of virtual assets, hold the distinctive feature of maintaining value stability through various mechanisms. These mechanisms encompass asset linkage and algorithmic control, with designs spanning currency-based, financial instrument-based, commodity-based, and virtual asset-based stablecoins. Algorithmic stablecoins, however, raise unique concerns due to their inherent risk factors, prompting caution among investors and regulators alike.

The Financial Services Commission approaches stablecoins with an emphasis on substance over form, adhering to the foundational principle of treating similar risks with similar regulations. Under the aegis of the Virtual Asset and Initial Token Offerings Services Act, stablecoins used for payment or investment purposes are classified as virtual assets. This classification ensures that the regulatory framework under the Act applies, with the Financial Services Commission serving as the overseeing authority.

In cases where stablecoin holders have redemption rights or direct claims on underlying reserve assets, a string of prudential standards comes into play. The issuer and custodian of these assets must ensure their sufficiency to honour the full value of stablecoin redemption. These standards encompass restrictions on re-hypothecation or re-use of reserve assets, meticulous valuation of assets against the pegged value of stablecoins, and safeguards against additional risks beyond the reference assets. Such measures underscore the commitment to ensuring financial stability and investor confidence.

Investors are urged to exercise caution and diligence when engaging with stablecoins. The Bank of Mauritius does not recognise stablecoins as legal tender, highlighting the need for informed decision-making. While stablecoins present opportunities for financial efficiency, they are not immune to price volatility, dispelling misconceptions of absolute safety. As a safeguard, investors are advised to exclusively transact with regulated entities and be aware that statutory compensation mechanisms do not extend to their investments in stablecoins.

The issuance of the guidance notes on stablecoins embodies a proactive and pragmatic approach to the evolving virtual asset landscape. By categorising stablecoins, prescribing regulatory standards, and emphasising investor vigilance, Mauritius takes a step towards fostering a resilient financial environment. As the virtual realm continues to transform, these guidance notes lay the foundation for a secure and harmonious co-existence of technological innovation and regulatory oversight. In embracing stability, Mauritius charts a course towards a promising future in the realm of virtual finance.

Guidance Note for Consultation on Decentralised Autonomous Organisations (DAO)

A new era of organisational evolution has dawned with the rise of Decentralised Autonomous Organisations (DAOs), blockchain-based entities operating under the guidance of self-executing smart contracts. This transformative paradigm brings forth novel opportunities and complexities that demand meticulous regulatory frameworks. In February 2023, the Financial Services Commission of Mauritius as regulator of non-banking financial services, presented draft guidance notes on DAOs for public consultation, outlining legal structures, governance expecta-

tions, and licensing requisites. This article delves into the core tenets of the issued guidance notes, deciphering the contours of DAO regulation in the Mauritian context.

DAOs, powered by smart contracts, stand as the pinnacle of decentralised orchestration, holding the potential to redefine traditional organisational hierarchies. These enigmatic entities are divided into two main categories: DAOs linked to legal entities, and those existing independently. The latter category, devoid of conventional legal ties, raises pertinent questions regarding structure and operation. The Mauritius Financial Services Commission addresses these issues through their comprehensive set of guidance notes, setting the stage for DAOs to thrive responsibly.

The guidance notes aim to illuminate the diverse legal structures available to DAOs in Mauritius, enabling seamless alignment between blockchain innovation and established legal frameworks. DAOs wishing to establish a connection to legal entities can choose from a selection of suitable structures, including limited partnerships, foundations or limited liability partnerships. These versatile structures ensure flexibility while upholding the benefits of legal personality and limited liability status.

The guidance notes articulate foundational principles applicable to DAOs, grounding them in an environment of transparency and compliance. DAOs must specify their decentralised autonomous nature in their constitutive documents and include indicators such as “DAO” in their registered name. Additionally, DAOs have the liberty to distinguish themselves as either member-managed or algorithmically managed, delineating the core mode of governance. Algorithmically managed DAOs, in particular, must publicly divulge their smart contract identifiers.

The presence of a representative agent for a DAO is paramount, ensuring effective communication and compliance with regulatory authorities. This agent serves as a conduit for official communications and statutory obligations. To meet this requirement, a licensed Management Company by the Financial Services Commission or an authorised resident entity assumes the role of the representative agent, facilitating seamless interaction between the DAO and Mauritian authorities.

DAOs are encouraged to embrace the potential of blockchain technology in their governance processes, further enhancing transparency and accountability. Operational contracts, policies and procedures should meticulously outline the mission, degree of decentralisation, voting procedures, and security breach response mechanisms. These provisions collectively ensure an environment of effective decision-making and security management within the DAO ecosystem.

In the pursuit of holistic governance, the guidance notes stress the necessity for DAOs to adhere to licensing, authorisation and registration requirements. DAOs providing financial services are reminded of their responsibility to meet Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) obligations under the Financial Intelligence and Anti-Money Laundering Act. Moreover, DAOs issuing tokens as fundraising mechanisms must align with the provisions of the Securities Act, including prospectus requirements.

The guidance notes conclude with an emphasis on dissolution mechanisms and investor caution. DAOs are provided guidelines for orderly dissolution, outlining scenarios ranging from contract expiration to regulatory intervention. It

is essential for members to ensure that dissolution aligns with Mauritian legal requirements. Investors and members alike are cautioned to view these guidance notes as informative tools and are encouraged to seek professional advice when navigating the intricate DAO landscape.

Mauritius' Financial Services Commission is seen to set a pioneering precedent by elucidating regulatory guidelines for the decentralised world of DAOs. Through insightful guidance notes, the Mauritian regulatory landscape evolves in tandem with technological progress, fostering a climate where DAOs can flourish while adhering to established legal norms. This dynamic synergy between innovation and regulation paves the way for a future where blockchain-based organisations thrive in harmony with structured oversight.

Conclusion

More than just the captivating landscapes of Mauritius, these trends and developments narrate a story of adaptability and foresight. The strategic recalibration of monetary policies reflects a nation attuned to the fluid nature of economics, shaping its strategies to meet the demands of a fluctuating landscape. The introduction of a digital currency echoes a commitment to convenience, security and embracing technological advancements while maintaining the allure of traditional finance. Simultaneously, the meticulous regulation of fintech entities underscores Mauritius' pursuit of financial excellence through robust governance. As the island nation navigates this intricate tapestry of trends, it casts a compelling light on the harmonious co-existence of innovation and regulation. Within this unique context, Mauritius stands as a testament to the harmonious integration of global financial currents with its own distinctive economic identity, illuminating a path that other nations can follow in their quest for financial evolution.

MEXICO

Law and Practice

Contributed by:
Michell Nader Schekaiban, Julián J. Garza Castañeda
and Paulina Bracamontes Belmonte
Nader, Hayaux & Goebel

Contents

Contributed by: Michell Nader Schekaiban, Julián J. Garza Castañeda and Paulina Bracamontes Belmonte,
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Nader, Hayaux & Goebel (NHG) is a market leader in M&A, banking and finance, fintech, securities and capital markets, structured finance, telecoms, tax, insurance and reinsurance, project finance, real estate, energy and infrastructure, restructuring and workouts, government procurement, antitrust and compliance. The firm comprises 16 partners, three of counsels and more than 40 associates. NHG is the only Mexican law firm that has an office in London, with a strong focus on developing and pursuing business opportunities between Mexico, the UK and other European countries. NHG also enjoys excellent working relationships with law firms in all major cities around the world.

Authors

Michell Nader Schekaiban is a partner at Nader, Hayaux & Goebel who specialises in structured and project finance, capital markets, restructuring, real estate and M&A. Michell has represented bank syndicates in some of the largest debt restructurings in Mexico and has particular expertise in US-Mexico cross-border cases. He advised the US Department of Treasury on the USD20 billion emergency financial package provided to the Mexican government and the US Commerce Department in the negotiation of the investment and financial services chapters of NAFTA, and served as Mexico delegate in an UNCITRAL session on international bills of exchange and promissory notes. Michell received his LLM in comparative law from Georgetown University.

Julián J. Garza Castañeda is a partner at Nader, Hayaux & Goebel who specialises in banking and finance, M&A, capital markets, telecoms and structured and project finance. He has advised on some of the largest structured finance and capital markets transactions, representing both sponsors and financial intermediaries. His most recent cases include securitisation deals related to infrastructure and financing projects, as well as local and cross-border issuances of securities, commercial financings and private equity funds. Julián regularly advises US and other international clients on their local operations or investments in the Mexican market. He worked in Chicago at Mayer Brown LLP and received his LLM from the University of Texas, where he taught Mexican business and commercial law. He is a professor of financial law at Universidad Panamericana in Mexico City and has been a lecturer of Mexican business and commercial law at the University of Texas in Austin. He is a member of the National Association of Corporate Counsel.

Paulina Bracamontes Belmonte is an associate at Nader, Hayaux & Goebel who specialises in banking and finance, M&A, project finance and financial regulatory matters. Paulina regularly advises banking and other financial institutions, as well as Mexican entities, in connection with the structuring, negotiation and formalisation of corporate and project finance loans and equity investments. She also has significant experience in financial regulatory matters. Paulina worked in New York at Simpson Thacher & Bartlett LLP and received her LLM degree in international business and economic law, and a specialisation certificate in securities and financial law from Georgetown University.

Nader, Hayaux & Goebel

Paseo de los Tamarindos No 400-B
7th Floor
Bosques de las Lomas
05120 CDMX
Mexico

Tel: +52 55 4170 3000
Email: info@nhg.com.mx
Web: www.nhg.com.mx

Contributed by: Michell Nader Schekaiban, Julián J. Garza Castañeda and Paulina Bracamontes Belmonte, Nader, Hayaux & Goebel

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

The recession triggered by the COVID-19 pandemic in 2021 certainly impacted the loan market in Mexico as in most other jurisdictions. Needless to say, economic conditions changed dramatically, altering both the demand for and supply of financing.

The impact of the pandemic was also felt in an increase in loan defaults. With many companies at risk of failing to meet debt obligations, as well as the potential risk for Mexican banks to face serious issues relating to capitalisation and reserves, the Mexican banking authorities introduced temporary regulations to mitigate such issues. These regulations were designed to ease the technical and regulatory requirements for Mexican banks in order to help them navigate the crisis.

While 2022 brought renewed optimism for growth in certain markets, the lingering global economic impact of the pandemic and disruptions to supply chains presented significant hurdles.

The ripple effects of the pandemic in 2021 and 2022, coupled with geopolitical tensions in early 2022, contributed to a global inflationary trend, and Mexico was no exception. In line with international trends, the Mexican Central Bank has raised and maintained high interest rates in 2023 to mitigate rising inflation. Despite the high interest rates, the first half of 2023 saw higher-than-expected levels of economic activity and employment, alongside a declining inflation rate. This confluence of factors led to a revitalisation of the loan market in the first half of 2023, mainly driven by consumer credit.

Markets in Mexico are fairly liquid and loans are flowing in a variety of forms, including in Mexico and across the border. The Mexican banking system remains stable, and the appetite among foreign lenders to invest in Mexico continues to be robust.

1.2 Impact of the Ukraine War

As Mexico does not have significant commercial relations with either Russia or Ukraine, the direct impact of the war on the Mexican economy has been limited. However, the war, combined with the international sanctions on Russia, escalating geopolitical tensions, and the ripple effects of the COVID-19 pandemic, have exacerbated the global inflationary trend. As a result, the Mexican Central Bank raised and maintained high interest rates throughout 2022 and 2023. Despite these headwinds, the loan market in Mexico has shown resilience, with positive performance in 2022 that has continued into 2023. The recovery of financial intermediaries' activities and effective risk management have collectively bolstered the loan market's performance.

From a transactional perspective, even though the Mexican government has not imposed any sanctions on Russia, Mexican banks with foreign affiliations are likely to adhere to the compliance policies set by their parent financial institutions. This includes stringent "know your customer" (KYC) processes and use-of-proceeds covenants, potentially limiting credit access for Russian borrowers in Mexico.

1.3 The High-Yield Market

High-yield transactions will always offer structuring challenges and complex collateral structures, particularly with regard to project finance transactions, where structuring and risk assessment is so dependent on prospect valuations and a

number of additional considerations, including ratings from rating agencies.

More often than not, innovation helps to establish adequate legal and financing structures that may accommodate market needs.

1.4 Alternative Credit Providers

The lenders market has again been diversified in Mexico. Non-bank institutions have taken a leading role in financing sectors of the economy that are not fully served by the traditional banking industry. *Sociedades Financieras de Objeto Múltiple, Sociedades Financieras Poulares* and a large number of new fintech-related lenders are active in the market; many of them receive funding from traditional banking sources. Nevertheless, in 2021 and 2022 a few non-bank institutions failed to comply with debt obligations, which created concerns about market stability and resulted in several restructurings and workouts.

Fintechs in the consumer lending business represent approximately a third of the Mexican fintech market. Initially operating without a comprehensive regulatory framework, these entities are now subject to specific regulations designed to instil consumer confidence.

Fintech companies have been a transformative force in Mexico's lending market, primarily due to their innovative use of technology and adoption of new business models. Their influence is particularly evident in several key processes:

- prospective client selection;
- implementation of compliance measures (especially KYC);
- risk assessment;
- fund disbursement; and
- determination of rates and payment terms.

The disruptive influence of fintech companies in the lending market has opened up new avenues for potential borrowers, particularly those keen on financing digital products and services. The fintech sector in Mexico has seen further robust growth in 2023, with the number of fintech companies increasing by approximately 20% compared to the previous year.

1.5 Banking and Finance Techniques

As mentioned in **1.4 Alternative Credit Providers**, banking and finance techniques are primarily adjusting to technological means that permit transactions to occur in a faster and safe manner.

1.6 ESG/Sustainability-Linked Lending

ESG lending is increasingly prominent in the Mexican lending market. Banks are prioritising loans that incorporate ESG elements and striving to comply with all the associated requirements. At the same time, the bond market is also growing extensively in the area of green and sustainable bonds. Over the past year, the number of ESG-related transactions has grown significantly.

For example, the disclosure of ESG information and adherence to the recommendations of multiple agencies, such as the Task Force on Climate-related Financial Disclosures and the Sustainability Accounting Standards Board, have been broadly promoted. However, in most cases, compliance with such recommendations remains optional.

2. Authorisation

2.1 Providing Financing to a Company

In Mexico, lending is not in itself a regulated activity. In other words, a regulatory licence is

not always mandatory to conduct lending activities. However, if lending constitutes a company's primary activity, it will likely need to operate as a regulated financial entity.

Requirements to operate as a regulated financial entity vary significantly depending on the type of financial entity involved. As a general rule, authorisation from the Mexican Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*, or CNBV) is required to operate as a regulated financial entity.

Mexican banks, for example, need to file an authorisation request with the CNBV, which shall include:

- information and corporate documents about the bank and its direct and indirect equity holders;
- corporate documents of the stockholders;
- information regarding proposed operations of the Mexican bank;
- multiple additional documents required by the CNBV;
- corporate structure information about the bank;
- information relating to the capitalisation of the bank; and
- information about officers and directors of the bank.

Licences are generally granted by the CNBV on a discretionary basis.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Foreign lenders are not restricted from granting loans to Mexican borrowers, nor from obtaining a security interest over assets owned by Mexican counterparts or located in Mexican territory to secure their financings.

Foreign lenders are not required to be specifically registered with, or approved by, governmental authorities in order to conduct lending activities in Mexico.

Lending activities of both foreign and local lenders in Mexico may be conducted through multiple structures, including unsecured lending, secured financing, club deals, syndication, structured finance, securitisation transactions, capital and operation leasing, bond offerings and factoring. Both Mexican and foreign banks are subject to specific regulations and limitations.

Subject to certain exceptions, to achieve a 4.9% withholding tax rate on interest payments of debt securities issued by a Mexican issuer and placed with foreign holders, the following conditions apply:

- the securities should be placed through bank or broker-dealers in a country with which Mexico maintains a tax treaty for the avoidance of double taxation; and
- filings with the CNBV and the tax administration must be completed.

3.2 Restrictions on Foreign Lenders Receiving Security

Foreign lenders may secure their loans with Mexican assets, while Mexican entities can guarantee the payment of loans of foreign lenders. However, it is important to be aware of Mexican laws regarding the granting of personal guarantees such as *fianzas*, *obligaciones solidarias* and *avales*. Statutory laws concerning *fianzas*, in particular, can limit the liability of the guarantor under a number of circumstances. Therefore, it

is important to consider waiving certain rights granted to the guarantor under Mexican law.

In the case of *avales*, which apply to Mexican *pagarés* (promissory notes), it is necessary to comply with Mexican laws applicable to negotiable instruments. Among other things, these laws allow the holder of the note to pursue claims through executive legal proceedings. To be enforceable, *avales* must adhere to the formal requirements outlined by Mexican law.

3.3 Restrictions and Controls on Foreign Currency Exchange

Other than tax reporting obligations that may apply to the borrower, there are no governmental registrations or approvals required for a Mexican borrower to contract debt obligations in a foreign currency or to remit funds abroad.

3.4 Restrictions on the Borrower's Use of Proceeds

There are generally no restrictions on the borrower's use of proceeds from loans or debt securities, except for limitations in certain regulated industries and as otherwise contractually agreed to.

3.5 Agent and Trust Concepts

Agency and trust concepts are recognised in Mexico.

Please see **5. Guarantees and Security**, **6. Enforcement** and **8. Project Finance** for information regarding Mexican trusts.

3.6 Loan Transfer Mechanisms

In Mexico, both loans and security interests can be transferred via the appropriate assignment and amendment mechanisms. The transfer of security packages may require the authorisation of third parties or of the entity granting the respective collateral. Additional steps, such as filings with regulatory and registration authorities, may also be required.

The transfer of account receivables does not require the authorisation of the debtor, unless otherwise contractually stipulated.

3.7 Debt Buy-Back

A debt buy-back by a related party is not expressly prohibited; however, it is not common practice in the commercial lending industry. Alternative mechanisms may be implemented to achieve a similar result.

3.8 Public Acquisition Finance

No information has been provided in this jurisdiction.

3.9 Recent Legal and Commercial Developments

In July, 2021, the World Bank announced that the Secured Overnight Financing Rate (SOFR) would replace the London Interbank Offered Rate (LIBOR) for USD-denominated loans, as well as the timeline for the implementation of the SOFR interest rate with respect to new loans and existing loans.

Even though the transition was made progressively, 30 June 2023 marked the final milestone in the transition as LIBOR settings ultimately ceased to be published. As of such date, parties were not allowed to enter into any USD loans referencing the LIBOR rate and any USD loans referencing such rate should be amended in order to implement the SOFR interest rate.

As a result, the Mexican legal and banking industries developed and implemented new legal provisions that would govern the interest rate in USD loans and its fallback provisions.

3.10 Usury Laws

Mexico has general usury statutes in place, but there are no explicit caps on the interest rates that can be charged to borrowers. However, limitations could arise from these usury statutes if a lender is deemed to be engaging in abusive practices, typically as determined by a competent judicial authority. Additionally, existing judicial precedents and market conditions may influence the rates that can be applied.

In respect of related party transactions, tax-related limitations may exist to prevent non-standard market interest rates. Such transactions often necessitate market studies to justify the application of a particular rate or other pricing considerations.

3.11 Disclosure Requirements

Under Mexican banking law, there is a general rule preventing banking institutions from disclosing any information concerning the transactions or services that they provide to their clients. This confidentiality extends to anyone other than the respective client or their legal representative, unless there is a prior written order from a Mexican authority with the requisite power and jurisdiction. This rule is replicated in several financial Mexican laws regulating different types of Mexican financial entities in order to protect the confidentiality of users of financial services.

4. Tax

4.1 Withholding Tax

In the case of interest payments to non-residents, withholding tax rates tend to range from 4.9% to 40%, depending on the tax residency of the beneficial owner of the interest and the existence of a double tax treaty with the lender's country of residence.

Mexico has enacted more than 40 double tax treaties and is in the process of negotiating more. Such tax treaties may reduce the withholding tax applicable in accordance with the Mexican domestic tax legislation. Under a number of these treaties, a preferential 4.9% withholding tax rate applies to interest paid to financial institutions resident for tax purposes in a treaty country.

Interest payments made to export-import banks granting or guaranteeing loans may not be subject to any withholding tax, provided that the conditions set forth by the relevant tax treaty are complied with.

Also, favourable tax treatment can be granted in a variety of cases, including the following:

- interest derived from securities issued by the federal government or the central bank, provided that the beneficial owner of the interest is a non-resident for tax purposes;
- interest derived from loans granted to the federal government, the central bank or derived from bonds issued by them; and
- interest derived from loans granted under preferential conditions, payable to foreign development financial institutions.

There are generally no different taxes applicable to loans payable to lenders in Mexico and loans payable to lenders in a foreign jurisdiction. In both cases, income tax is the only tax levied on interest payments. As noted above, interest payments may be subject to different withholding tax rates depending on the tax residency of the beneficial owner.

4.2 Other Taxes, Duties, Charges or Tax Considerations

VAT may apply to interest payments, subject to certain exceptions. Exceptions include interest payments made to Mexican financial institutions that may be exempt from such tax in certain instances.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

It is not unusual for cross-border financing transactions to be governed by foreign laws; in the case of US lenders, it is common to choose the laws of New York. However, when a Mexican borrower is involved, foreign lenders are typically concerned with the tax rate applicable on interest accrued on the respective loan, as this shall be subject to Mexican law.

A careful analysis is required to determine the applicable tax interest rate and to customise adequate gross-up provisions for each specific lender. However, as a general rule, Mexican law provides for a 4.9% withholding tax rate on interest payments of debt securities issued by a Mexican issuer and placed with a foreign holder, subject to the following conditions: (i) the securities should be placed through a bank or a broker-dealer in a country with which Mexico has a double taxation treaty; and (ii) filings with the CNBV and Mexican tax authorities shall be made.

5. Guarantees and Security

5.1 Assets and Forms of Security

Assets typically available as collateral include real estate, machinery and equipment, stock or equity interests, receivables and collection rights, among many others. There are generally no restrictions with respect to creating security interests over any sort of movable assets that can be transferred, including rights.

Collateral instruments include:

- the traditional pledge, where the collateral is (in principle) delivered to the secured party or a depositary;
- the non-possessory pledge (*prenda sin transmisión de posesión*), which permits the borrower to maintain custody and use of the pledged assets; and
- the guaranty trust (*fideicomiso de garantía*), where the collateral is actually transferred to a Mexican trustee (ie, a Mexican banking institution).

Pursuant to a guaranty trust, a borrower may transfer to a trustee ownership of certain assets. The trustee will hold ownership of such assets as collateral for the primary benefit of the corresponding lender, who will be appointed as a beneficiary (*fideicomisario*) of the guaranty trust. The guaranty trust permits:

- borrowers to continue to use and manage the collateral and maintain regular business activities; and
- parties to the guaranty trust to contractually establish their own tailor-made rules of extrajudicial foreclosure (within reasonable due process and other requirements).

Such foreclosure procedure permits the transfer of collateral to a lender, subject to compliance with the applicable legal requirements. Similar benefits may be attained through a non-possessory pledge, with respect to the use of collateral and business activities of the borrower.

The non-possessory pledge and the guaranty trust are the most common forms of granting

and perfecting a security interest in receivables and accounts. The non-possessory pledge and the guaranty trust must be registered with the Movable Property Registry (*Registro Único de Garantías Mobiliarias* or RUG) to be effective against third parties. A guaranty trust over real estate property shall also be registered with the corresponding local Public Registry of Property (*Registro Público de la Propiedad* or RPP).

Also, the most common form of granting a security interest over real estate is through a mortgage, which must be registered with the Public Registry of Property that has jurisdiction over the place where the real estate is located.

See **6.1 Enforcement of Collateral by Secured Lenders** for further information regarding formalities and perfection requirements.

5.2 Floating Charges and/or Similar Security Interests

Mexican law permits a security interest over all present and future assets of a company, primarily through a non-possessory pledge or a guaranty trust.

5.3 Downstream, Upstream and Cross-Stream Guarantees

It is possible for entities in Mexico to give downstream, upstream and cross-stream guarantees. There are typically no associated limitations; however, the guarantee shall generally create a benefit for the guarantor to avoid the risk of being considered null in a bankruptcy scenario.

5.4 Restrictions on the Target

There are no particular restrictions.

5.5 Other Restrictions

There are a number of additional Mexican legal considerations in connection with loans to borrowers and the granting of security interests or guarantees. Please refer to the responses throughout this chapter in this respect.

Each transaction must be assessed considering a variety of factors, including tax treatment, the regulatory framework, bankruptcy scenarios, the parties involved and the nature of collateral. The issue of costs must also be taken into consideration. Implementing collateral structures involving trustees or real estate assets may be more costly, as they require the involvement of third parties, including notaries, and registrations with public registries.

5.6 Release of Typical Forms of Security

Typical forms of security are released through amendment, termination and/or release instruments. Collateral instruments – such as mortgages, pledges and security trusts – that have been registered in public registries require the filing of such termination or release documents in the respective registries in order for the release to be effective against third parties. Additional filings may be required when dealing with regulated entities.

5.7 Rules Governing the Priority of Competing Security Interests

As a general rule, secured lenders have priority over the assets granted to them as collateral in the event of foreclosure and in an insolvency scenario, although subject to a variety of exceptions.

Since the 2014 amendment to the Mexican Insolvency Law, contractual subordination is expressly recognised in the case of an insolvent entity. Mexican courts recognise the subordination of contractually subordinated claims with respect to other secured or unsecured claims of creditors of an insolvent entity.

Also, intercreditor agreements are commonly used in Mexico. They constitute the framework regulating the relationship between lenders in a syndicated facility, or between lenders under several financings. It is common to appoint an administrative agent (also known as a collateral agent).

The most common vehicle to achieve structural subordination is a trust containing a payment waterfall with subordinated payments.

5.8 Priming Liens

Mexican Bankruptcy Law provides for several types of creditors and establishes a specific hierarchy for the prioritisation and payment of their respective claims. By law, labour and tax credits take precedence and are paid immediately after any creditor holding collateral over a specific asset, such as a pledge or mortgage, but before any other type of creditor.

Due to their inherent nature, the payment of labour and tax credits is accorded special status and takes priority over the payment of common credits, solely by virtue of the law.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

A secured lender who has a perfected security interest over its collateral has, in principle, no limitations to enforce its rights in a court of law, subject to bankruptcy and insolvency rules. Enforcement of security in Mexico is generally conducted through Mexican courts.

Loan and collateral documents must comply with the Mexican legal formalities required for their enforceability and perfection in Mexico. Enforceability of obligations before a Mexican court may often be contingent on:

- the valid existence of the borrower;
- the authority of the borrower and its representatives to assume such obligations pursuant to any provisions of relevant by-laws;
- corporate authorisations and powers of attorney; and
- the absence of conflicts with applicable law and third-party obligations or contractual arrangements.

A number of formalities concerning loan documentation must be met to avoid difficulties in the enforcement process.

Loan obligations are usually documented in promissory notes (*pagarés*). The documentary formalities applicable to promissory notes (*pagarés*) are very strict and failure to meet them may result in a court refusing to grant them specific procedural benefits. A promissory note (*pagaré*) will entitle its holder, whether a Mexican or foreign lender, to claim a judicial "executive action", which carries certain procedural benefits, including the right to attach assets of the debtor upon service of process being made. Note that Mexican banks and certain other financial entities also have executive actions through other types of documents, including certified account statements and loan agreements.

With regard to collateral documents, certain security instruments, including mortgages, pledgor-in-possession pledge agreements and guaranty trusts on real estate assets, are required to be formalised before a Mexican notary public and registered with the corresponding Mexican public registry (ie, the local Public Registry of Property or the Federal Registry of Movable Property).

A lien on other assets may require additional formalities – for example, registration with intellectual property registries if such lien is created on certain intellectual property rights.

A guaranty trust permits a borrower and a lender to agree on the terms and conditions to conduct an out-of-court foreclosure procedure, which may consist of a sale process to third parties or a direct transfer of collateral to a lender. Any agreed-upon out-of-court foreclosure procedure must comply with very specific rules and may be subject to challenges in a Mexican court.

Challenges to the enforcement of a security include gaining possession over the collateral to be realised either due to statutory restrictions or because the collateral is in the possession of a third party.

6.2 Foreign Law and Jurisdiction

Under Mexican law, the choice of foreign law should be recognised and enforced, other than in specific cases, such as, for example, collateral instruments that create a security interest over assets located in Mexican territory, which shall be generally subject to Mexican law.

With respect to the submission to a foreign jurisdiction, there are no specific limitations for Mexican parties to do so.

A judgment rendered by a foreign court, pursuant to a legal action instituted before such court in connection with an outstanding loan, would be enforceable against the borrower in the competent courts of Mexico, provided that:

- such judgment is obtained in compliance with:
  - (a) the legal requirements of the jurisdiction of the court rendering such judgment; and
  - (b) all legal requirements of the respective transaction documents;
- such judgment is strictly for the payment of a certain sum of money, based on an in personam (as opposed to an in rem) action;
- the judge or court rendering the judgment was competent to hear and judge on the subject matter of the case in accordance with accepted principles of international law that are compatible with Mexican law;
- service of process is made personally on the defendant or on its duly appointed process agent; note that service of process by mail does not constitute personal service of process under Mexican law and, given that such service of process is considered to be a basic procedural requirement, a final judgment based on such process would not be enforced by the courts of Mexico;
- such judgment does not contravene Mexican law, the public policy of Mexico, international treaties or agreements binding upon Mexico, or generally accepted principles of international law;
- the applicable procedure under Mexican law is complied with when enforcing foreign judgments, including:
  - (a) the issuance of a letter rogatory by the competent authority of such jurisdiction requesting enforcement of such judgment; and
  - (b) the certification of such judgment as authentic by the corresponding authorities of such jurisdiction in accordance with the laws thereof;
- the action in respect of which such judgment is rendered is not the subject matter of a lawsuit between the same parties that is pending before a Mexican court;
- such judgment is final in the jurisdiction where it is obtained;

- the judgment fulfils the necessary requirements to be considered authentic; and
- the courts of such jurisdiction recognise the principles of reciprocity in connection with the enforcement of Mexican judgments in such jurisdiction.

6.3 Foreign Court Judgments

See **6.2 Foreign Law and Jurisdiction** regarding enforcement of a foreign court judgment.

6.4 A Foreign Lender's Ability to Enforce Its Rights

The following additional matters might impact a foreign lender's ability to enforce its rights under a loan or security agreement.

- In the event that proceedings are brought in Mexico seeking performance of the obligations of the borrower in Mexico, pursuant to the Mexican Monetary Law, the borrower may discharge its respective obligations by paying any sums due in a currency other than Mexican currency in Mexican currency at the exchange rate prevailing in Mexico and fixed and published by the Mexican Central Bank (*Banco de México*) in the Official Gazette of the Federation (*Diario Oficial de la Federación*) of Mexico on the date preceding the date of payment.
- In the event that any legal proceedings are brought in the courts of Mexico concerning transaction documents prepared in English, a Spanish translation of such documents required in such proceedings prepared by a court-approved translator would have to be approved by the court after the defendant had been heard with respect to the accuracy of the translation. Proceedings would thereafter be based on the translated documents.
- The enforceability of the terms of certain financing and collateral documents may, for example, be limited by bankruptcy, insolvency, *concurso mercantil* or other laws relating to creditors' rights generally.
- When evaluating available enforcement options, it must be considered that remedies may not be cumulative or exercised concurrently.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

As a general rule, the enforceability of the terms of certain financing and collateral obligations may be limited by bankruptcy, insolvency, *concurso mercantil* or other laws relating to creditors rights generally.

Provided prior authorisation of the Insolvency Court is obtained and subject to its supervision, secured creditors under a mortgage or a pledge may foreclose on their collateral.

Under Mexican Insolvency Law, trust assets are excluded in principle from the estate of the insolvent entity to the extent that they have been validly conveyed to the security trust. Therefore, if the collateral is subject to a security trust, the first beneficiary (lender) under the trust agreement may commence an extrajudicial foreclosure procedure outside the insolvency proceeding. Such rule, however, may be subject to exceptions and the final determination of the Insolvency Court.

Provided there is an insolvency judgment in place, the following effects will arise:

- the insolvent entity's unsecured obligations in Mexican pesos will be converted into indexed units of account (*unidades de inversión,* or UDIs), and interest will stop accruing;

- any unsecured obligations contracted in foreign currency will be converted into Mexican pesos and then into UDIs; and
- secured obligations will be kept under the currency they were contracted in, and may continue to accrue ordinary interest up to the amount of the respective collateral.

The insolvent entity's obligations will then become due. However, their payment is subject to:

- entering into a reorganisation agreement between the insolvent entity and its court-approved creditors; or
- the bankruptcy declaration of the insolvent entity, containing the sale of its assets under a court-supervised liquidation.

7.2 Waterfall of Payments

Under Mexican law, the distribution of proceeds from the liquidation of an insolvent entity's assets for creditor repayment is structured as follows:

- (i) labour claims for salaries and severance corresponding to the immediate calendar year preceding the insolvency judgment;
- (ii) claims arising from financing incurred for the management of the estate of the insolvent entity or financing that is essential to maintain the ordinary operations of the company and the necessary liquidity during the insolvency proceeding – in each case, as approved by the mediator or by the Insolvency Court;
- (iii) liabilities and obligations of the estate of the insolvent entity;
- (iv) costs and expenses incurred as a consequence of the judicial and extrajudicial proceedings for the benefit of the insolvency estate;
- (v) amounts paid to the secured creditors;
- (vi) labour claims different from those described in (i) above;
- (vii) claims of "preferred" creditors under the Mexican commercial laws only to the extent of the value of their respective privilege;
- (viii) claims of unsecured creditors; and
- (ix) claims of subordinated creditors and creditors qualifying as related parties of the insolvent entity.

Notwithstanding the above, claims of secured creditors would be paid on a supra-priority basis up to the amount of the respective collateral. However, this is contingent on the following claims having priority over the amount of such collateral in the order that follows:

- labour claims for salaries and severance for the calendar year preceding the issuance of the insolvency judgment;
- litigation expenses related to the defence or recovery of secured assets; and
- expenses necessary for the maintenance, disposition and repair of the secured assets.

7.3 Length of Insolvency Process and Recoveries

The first stage in bankruptcy proceedings is to determine whether the legal requirements to declare the respective merchant bankrupt are met. The lawsuit may be filed by the merchant, its creditors or the Public Prosecutor (*Ministerio Público*). The first stage lasts around a month and a half and if proceedings move forward, the judge will issue a bankruptcy ruling.

Once an insolvency ruling is published in the Federal Official Gazette (*Diario Oficial de la Federación*), the bankrupted company has up to 185 days to enter into an agreement with its respective creditors. Such period may be extended for an additional term if the creditor(s) who

represent(s) 50% or more of the aggregate debt consider(s) an agreement is likely to be entered into soon. The conciliation stage cannot exceed 365 days.

In the event no conciliation or agreement is reached, the *quiebra* (liquidation) stage shall begin. This stage has the purpose of dissolving the company and selling and distributing any remaining assets among its creditors (in the order and priority provided under Mexican Bankruptcy Law). The duration of this stage largely depends on the speed at which the company's assets are sold; however, the law provides for a six-month term for the assets to be sold before starting a public auction. In the event a public auction is conducted, it shall occur within a 90-day term.

Mexican legal proceedings and resolutions issued thereunder are subject to several legal remedies which may substantially delay the issuance of a final ruling and the enforcement thereof.

Whether creditors will obtain full repayment of their credits depends on the size of the bankruptcy assets and the amount of the credits. If the entity is technically insolvent (the amount of liabilities exceeds the amount of assets) it is unlikely that all creditors will be able to obtain repayment of 100% of their respective credits, as Mexican Bankruptcy Law provides a particular order and priority in which credits would be repaid. Creditors without any legal privilege or preference would be repaid from any remaining assets, alongside other creditors in similar circumstances, on a pro-rata basis.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Other than the insolvency proceedings (*concurso mercantil*), there are no other statutory rescue or reorganisation procedures in Mexico.

7.5 Risk Areas for Lenders

Lenders should always make sure that they observe all the requirements applicable to the perfection of security interests over assets. Provided that all the formal requirements have been met when issuing a guarantee or a security by a third party, a risk area for lenders is that guarantees and securities may be at risk of being set aside if they were granted by an entity within a certain period prior to the onset of the insolvency. This is known as fraudulent conveyance, and would take place if:

- the securing entity received considerably less consideration than that of a fair market standard; or
- the guarantee was created within the statutory criterion of 270 days before the date on which the guarantor is found to be insolvent by a Mexican court.

Therefore, upstream guarantees may be problematic under the Mexican Insolvency Law, unless the Mexican guarantor receives a corporate benefit from the financing that serves as legitimate consideration for the grant of the guarantee or collateral.

8. Project Finance

8.1 Recent Project Finance Activity

Project finance in Mexico has existed for many decades. Thirty years ago, infrastructure projects were primarily funded through government spending and through international governmen-

tal agencies, such as the Export-Import Bank of the United States. More recently, public-private partnership (PPP) structures have diversified project finance alternatives. Banks and private investors are also more willing to absorb the risks associated with project finance, given the confidence they have gained with regard to collateral structures and the viability of certain projects.

Please refer to **8.2 Overview of Public-Private Partnership Transactions** regarding PPPs.

8.2 Public-Private Partnership Transactions

Federal PPPs in Mexico are, among other statutes, regulated by:

- the Public-Private Partnerships Law (the "PPP Law");
- the Regulations of the Public-Private Partnership Law (the "PPP Regulations"); and
- the guidelines that establish criteria for determining the feasibility of executing a project under a PPP scheme.

PPPs might also be impacted by provisions contained in:

- the Mexican Constitution;
- the Public Sector Acquisitions, Leasing and Services Law;
- the Code of Commerce;
- the Federal Civil Code;
- the Federal Law of Administrative Procedure; and
- the Federal Code of Civil Procedure.

In accordance with the PPP Law, PPP projects can only apply to sectors in which private individuals or entities can participate according to the applicable laws of each sector. Also, the PPP Regulations may prohibit state productive enterprises from executing PPP contracts with developers for activities related to the exploration and exploitation of hydrocarbons.

There are many other requirements and restrictions applicable to PPP projects.

8.3 Governing Law

Generally, under Mexican law, parties to civil and commercial transactions may validly designate the applicability of foreign laws and submit expressly or tacitly to the courts of a foreign jurisdiction (which may be the domicile of any of the parties, the place where the obligations shall be performed or the location of the assets subject to the transaction). Other than specific exceptions (such as public policy), a Mexican judge will apply any foreign laws that the parties have validly designated as governing laws to the particular transaction. Likewise, subject to several requirements, a final and conclusive judgment obtained from a court of a foreign jurisdiction to which the parties have validly submitted, will be recognised and enforceable by a Mexican court in Mexico. Note that, in all cases the Mexican courts will apply Mexican procedural law.

In the case of project financing, the parties shall carefully analyse whether it is permissible and convenient to subject a particular contract or agreement to a specific governing law or to have the parties thereto submit to a specific jurisdiction. For purposes of such analysis, the following factors may be relevant: the domicile of the parties, the location of the assets underlying the specific contract, the place where the obligations will be performed, and whether the respective agreement is subject to mandatory local legislation (eg, in case of regulated industries).

8.4 Foreign Ownership

In accordance with article 27 of the Mexican Constitution (*Constitución Política de los Estados Unidos Mexicanos*), it is expressly prohibited for foreign entities or foreign individuals to directly own real property or water rights within a 100-kilometre radius along the borders and 50-kilometre radius along the coastline (the "Restricted Zone").

However, foreign entities and foreign individuals may acquire indirect ownership or rights over land or water located within the Restricted Zone; this could be done either through a Mexican company (of which the foreign acquiror is a shareholder or partner) or through a Mexican trust (in which a Mexican financial institution acts as the trustee and direct owner of the property and the foreign acquiror acts as the beneficiary).

In any case, indirect ownership through any of the alternatives mentioned above may be subject to obtaining authorisation from the Ministry of Foreign Relations (*Secretaría de Relaciones Exteriores*) or filing notices with such authority.

8.5 Structuring Deals

The main issues that need to be considered when structuring the deal and the legal form of a project company, and the laws relevant to project companies, are outlined below:

- construction and operational risk;
- prospect valuations;
- deployment of funds and contractor performance;
- rating agency assessments of the transaction;
- debt servicing structures and waterfalls;
- identifying all parties involved in the transaction and their respective roles;
- collateral package and flow of funds; and
- specific regulations applicable to the project entities, and permits and licensing.

Foreign investment restrictions in Mexico apply to a few industries.

8.6 Common Financing Sources and Typical Structures

Lending activities of both foreign and local lenders in Mexico may be conducted through multiple structures, including secured lending, club deals, syndication, structured finance, securitisation transactions and bond offerings.

There are no specific restrictions applicable to the structuring of project financings. Two common sources of funding available are project bond offerings (both public and private) and bank syndicated loans, including those with the participation of export credit agencies (which are generally subject to beneficial tax treatment).

As with every project financing, the structure can be as complex as the project itself, depending on a variety of factors, including construction, operational and management risks. Project finance structures tend to be heavily collateralised. Collateral usually includes:

- pledges over the equity of the borrowers;
- specific liens on the project assets, achieved through security trust, pledge and mortgage collateral instruments; and
- assignment mechanisms of receivables stemming from the operation of the respective projects.

Most recently, project financings in Mexico have taken place in the infrastructure and real estate industries. In both cases, financings have occurred through bank lending and bond offerings (both private and public) via the issuance

of securities in local and foreign markets. In the infrastructure market, for example, it has been possible to securitise payments under PPP agreements for the development or improvement of toll roads through complex structures that have been well received in the marketplace.

As previously mentioned, there are generally no restrictions with regard to foreign lenders implementing security structures with Mexican parties or with assets located in Mexican territory. Mexican law is innovative and sophisticated, allowing the perfection of security liens over both movable and real estate assets.

8.7 Natural Resources

No information has been provided in this jurisdiction.

8.8 Environmental, Health and Safety Laws

The main environmental, health and safety laws that apply are:

- the Ecological Balance and Environmental Protection General Law and its regulations;
- the Environmental Liability Federal Law;
- the Law of the National Agency for Industrial Security and Environmental Protection for the Hydrocarbon Sector;
- the National Waters Law; and
- the Prevention and Comprehensive Management of Residues Law.

The main regulatory bodies include:

- the Ministry of Environment and Natural Resources (*Secretaría del Medio Ambiente y Recursos Naturales*);
- the Federal Attorney Office for Protection of the Environment (*Procuraduría Federal de Protección al Medio Ambiente*); and
- the National Water Commission (*Comisión Nacional del Agua*).

Trends and Developments

Contributed by:
Felipe Fernández Peña, Alfredo Gómez Pérez, Mauricio Jaime González and Patricio Yañez Fernández
Villarreal, García Campuzano, Gómez y Fernández

Villarreal, García Campuzano, Gómez y Fernández (Villarreal-VGF) is based in Monterrey, Mexico. The firm's 15-strong team of lawyers has extensive experience in debt and financial transactions and in-depth knowledge of the Mexican financial market. Villarreal-VGF advises Mexican and foreign companies, public and private, including family offices, FIBRAs, CKDs, highly leveraged issuers and companies in restructuring processes. Villarreal-VGF also represents Mexican and international financing sources, including some of Mexico's largest commercial banks, such as Banorte and BBVA, international development banks, such as NADB, non-banks, such as sofomes and sofipos, debt structuring firms, private debt funds and private debt managers, insurance companies and other international institutional lenders. Villarreal-VGF has participated in and contributed value to a wide variety of financing transactions, including domestic and cross-border transactions, which include syndicated facilities, senior and unsecured financings, acquisition financings, project financings, aircraft financings, structured financings to Mexican non-banks, and real estate financings, including in the industrial, retail, offices, and housing areas.

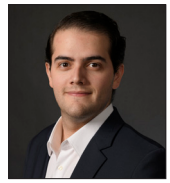
Authors

Felipe Fernández Peña is a partner at Villarreal-VGF, admitted to practice in Mexico and New York. Felipe specialises in corporate and financing transactions. He has represented banks, sofomes, funds and other financial institutions, as lenders, and corporations and investment vehicles, as borrowers and debt issuers, in connection with syndicated and bilateral loans, structured financings, project financings, acquisition financings, real estate financings, bridge loans, financings to financial entities, debt offerings and restructurings and workouts.

Alfredo Gómez Pérez is a senior partner at Villarreal-VGF. Alfredo specialises in banking and securities transactions, refinancings and restructurings, and M&A. He has represented Mexican public companies in debt capital markets transactions, such as CEMEX, CrediClub and KOF. Alfredo has extensive experience in structured financing, aircraft financing, restructurings, and M&A. Alfredo is a member of the board of directors of several companies in the industrial, financial, and philanthropic sectors.

Contributed by: Felipe Fernández Peña, Alfredo Gómez Pérez, Mauricio Jaime González and Patricio Yañez Fernández, **Villarreal, García Campuzano, Gómez y Fernández**

Mauricio Jaime González is a senior associate at Villarreal-VGF. Mauricio specialises in financing transactions. Mauricio has advised Mexican financial entities in multiple structured financings backed by receivables and has advised Mexican and foreign banks on various financial facilities, including real estate financing and corporate senior financing.



Patricio Yañez Fernández is an associate at Villarreal-VGF. Patricio has focused his legal practice primarily in the corporate, banking and finance, and real estate areas. He has represented domestic and international real estate developers and banks in real estate transactions and real estate financing. Patricio has also participated in the structuring and development of real estate projects.

Villarreal, García Campuzano, Gómez y Fernández, S.C.

Torre VAO 1
David Alfaro Siqueiros 104 – 204
Col. Valle Oriente
66278
San Pedro Garza García, N.L.
Mexico

Tel: +52 81 2140 6900
Email: info@vgf.law
Web: www.vgf.law

Contributed by: Felipe Fernández Peña, Alfredo Gómez Pérez, Mauricio Jaime González and Patricio Yañez Fernández, **Villarreal, García Campuzano, Gómez y Fernández**

The Impact of "Nearshoring" in Mexican Banking Deals

In 2023, the term "nearshoring" has become a buzzword in Mexican business circles. Through this practice, foreign companies are relocating their production sites closer to their US and Canadian consumers to minimise supply chain disruptions.

The increase in Mexican nearshoring has been driven by several factors, including US tariffs imposed on China, supply chain disruptions caused by global events such as the outbreak of the war in Ukraine and the COVID-19 pandemic, as well as the economic advantages offered by Mexico's geographic location, its numerous free trade agreements, and its labour force.

The nearshoring trend has led to increased foreign investment in Mexico, job creation, and a demand for land to develop industrial sites. Both local and foreign investors are now focusing on investing in industrial real estate portfolios, and the banking sector is supporting these investments by financing the acquisition of stabilised industrial assets or the development of industrial sites.

Considering the significant impact of nearshoring on the increase in banking deals related to industrial portfolios, this article shall provide an in-depth analysis of the main legal terms and conditions of a banking transaction involving Mexican borrowers whose funds are used to finance the acquisition or development of industrial properties.

Financed Assets and Uses of Funds

Uses of funds

These financings are used to fund:

- the acquisition of industrial real estate stabilised assets leased to tenants with good credit ratings and acceptable to the lenders;
- the construction of industrial sites under long-term leases agreed upon between the borrower and a tenant with a good credit rating and acceptable to the lenders; or
- the construction of industrial sites with speculative purposes, located in primary markets, to be leased during or after their construction.

Construction financing involves multiple disbursements of a loan amount determined by the project's cost. Borrowings are made based on the financial and physical progress of the construction, validated by an independent supervisor appointed by the lenders and the borrower.

Primary markets

The real estate and financing market in Mexico has recognised certain geographic locations within Mexican territory as primary markets. Nearshoring has had a greater impact in these areas due to, among other reasons, their qualified labour force, geographical location, tax benefits, and investment facilities. Such locations include the northern states of Mexico, such as Nuevo León, Baja California, Coahuila, and Chihuahua, as well as Mexico City, the State of Mexico, Querétaro, and Guadalajara.

Interest rate and currency

Applicable margins on interest rates vary depending on whether the financed asset is stabilised or under construction. If under construction, the interest rate may differ depending on whether the industrial building is being developed pursuant to an executed lease agreement

or for speculative purposes. The currency of the financing (usually Mexican pesos or US dollars) is determined based on the currency of the rent payments agreed upon by the borrower with the tenant. Dual currency financings are structured when the financed assets comprise a portfolio of tenants paying rent in US dollars and Mexican pesos.

VAT financing

Financing conditions may include an additional tranche to be used to finance the VAT payable by the borrower in the acquisition of stabilised assets or in the expenses incurred during the construction of the industrial site. The source of payment for the financing is the refund of VAT in favour of the borrower from the tax authorities. Such refunds are deposited by the tax authorities in a bank account maintained by the borrower. VAT refunds by Mexican tax authorities are made in Mexican pesos. This is an important factor when the primary financing is denominated in US dollars. Lenders typically request an opinion from an independent tax expert to verify the correct calculation of VAT subject to a tax refund and ensure compliance with Mexican tax regulations.

Macro facilities

A macro facility can be structured to encompass financing for future projects to be acquired or developed by existing or additional borrowers under the same credit agreement. However, as these projects have not been analysed and approved by the credit committees of the lenders, special considerations need to be addressed in the credit agreement to allow for such approval before financing. In the case of a syndicated facility, the credit agreement should outline the approval process among the lenders and regulate the scenario if one or more lenders do not approve a future project (eg, if a tenant is not acceptable to one or more lenders).

Sustainable financing

Some lenders offer the possibility of accessing preferential interest rates if real estate projects comply with key performance indicators related to environmental sustainability. Compliance is measured periodically during the financing and audited by an independent sustainability expert.

Credit Agreements, Lenders, and Promissory Notes

Credit agreements

The loans and financing terms and conditions are documented and agreed upon through a credit agreement involving the borrowers, the lenders, and, in the case of a syndicated facility, an administrative agent. The credit agreement may be governed by Mexican laws or foreign laws, and the parties to the credit agreement may submit to the jurisdiction of Mexican or foreign courts. While Mexican law does not require specific formalities or registration for the execution of a credit agreement governed by Mexican law or for its perfection, Mexican banks and non-banks usually request that such credit agreement governed by Mexican law be ratified before a Mexican public attester (*notario* or *corredor público*).

Lenders

Lending in Mexico is not restricted to a particular type of entity. Any person, whether national or foreign, may grant loans to Mexican individuals or entities. However, the tax treatment of interest payments varies depending on the type of entity acting as the lender. Interest payments to non-residents are subject to withholding tax, ranging from 4.9% to 40%, depending on the beneficial owner of the interest. Interest payments to Mexican residents who are non-financial entities are

subject to VAT. Foreign lenders are not required to be licensed, registered, or otherwise qualified to engage in lending activities in Mexico.

Promissory Notes

Promissory notes (*pagarés*) are credit instruments executed by the borrower and guarantors (as *avales*) in favour of each lender to document a borrowing under the credit agreement. These promissory notes are executed on the borrowing date, indicating the principal amount of the borrowing owed to the respective lender. The execution of promissory notes entitles the lenders to access executive judicial proceedings in the event of a default.

Promissory notes must comply with certain requirements stipulated in Mexican law and must include specific text to be recognised as "pagaré" under Mexican law. There are no specific formalities or registration requirements for the execution or enforcement of a promissory note governed by Mexican law. However, the attorney-in-fact of the debtor and the guarantors (*avales*) require specific authority for the execution of promissory notes, which must comply with certain formalities required by Mexican law.

Interest rate hedge

The structure of these financings usually requires the borrower to obtain an interest rate hedge, typically in the form of a cap or a swap. Hedge providers typically request that the payment obligations of the borrower under the hedge be secured with the same collateral package granted to the lenders.

Collateral

These financings are structured as senior secured facilities. The collateral is established in favour of the lender (in the case of a bilateral facility) or in favour of a collateral agent (in the case of a syndicated facility). There are no restrictions in Mexican law regarding the creation of liens in favour of a foreign lender or collateral agent. However, the collateral documents must be governed by Mexican law, and the parties must submit to the jurisdiction of Mexican courts.

The common collateral package for these financings in Mexico typically includes the following.

Real estate assets

Real estate assets can be transferred to a security trust (*fideicomiso de garantía*) established with a Mexican trustee for the benefit of the lender or the collateral agent, or mortgaged in favour of the lender or the collateral agent.

Security trust agreement

A security trust is created through an agreement entered into by the borrower (as trustor), a Mexican financial institution (as trustee), and the lender or collateral agent (as the first-place beneficiary). Under the security trust agreement, the borrower transfers ownership of the real estate property to the trust estate, primarily to secure obligations arising from the credit agreement, provided that the borrower typically retains reversion rights, allowing the transferred assets to revert to the borrower upon satisfaction of the secured obligations.

The inclusion of reversion rights is designed to ensure that the transfer of property is not treated as a sale solely for tax purposes, thereby avoiding the payment of transfer taxes related to real estate property sales. However, the trustee is considered the owner of the transferred property for civil and commercial purposes. Under insolvency procedures, trust assets are typically excluded from the estate of the insolvent entity (ie, the borrower).

In cases where the borrower is structured as a trust, which is common in real estate investment structures, it is recommended that the financial institution serving as a security trustee is different from the one serving as the trustee of the borrower's trust. This helps avoid potential conflicts of interest in foreclosure procedures.

The security trust agreement covers various aspects, including the rights and obligations of the borrower related to the management and operation of the real estate property and an extrajudicial foreclosure procedure. The trust agreement must be ratified before a Mexican public attester (*notario* or *corredor público*) or executed through a public deed prepared by a notary public and registered with the public registry of property corresponding to the location of the real estate assets.

Mortgage

An additional option for creating a lien on real estate assets is a mortgage in favour of the lender or collateral agent. The mortgage must be executed through a public deed prepared by a notary public and registered with the public registry of property corresponding to the location of the real estate assets. Under the mortgage, the property remains in the borrower's estate and may be subject to additional liens of lower priority in favour of other creditors.

Debt service reserve

Typically, these structures include a three-month debt service reserve, established in a reserve account opened by the security trustee.

Collection rights and waterfall

Collection rights arising from lease agreements and hedge agreements are assigned to the security trustee through assignment agreements. These assignment agreements must be ratified before a notary public or executed through a public deed and registered with the Sole Registry of Liens over Movable Assets. Tenants and hedge providers must be notified of the assignment of collection rights. The assignment notice may be delivered before two witnesses or a notary public or executed by a legal representative of the tenant or the hedge provider. Rent payments and payments in favour of the borrower under the hedge agreement are required to be deposited directly by tenants and the hedge provider into the trust accounts.

The application of payments deposited in the trust accounts is governed by a waterfall clause set forth in the trust agreement. A typical waterfall arrangement includes the following elements:

- transfer of VAT paid by tenants to the borrower;
- payment of trust expenses;
- payment of debt service in favour of the lender or collateral agent;
- maintenance of the debt service reserve; and
- transfer of any residual amounts to the borrower.

Pledge over VAT bank account

VAT refunds are deposited by tax authorities into a bank account maintained by the borrower. A pledge over this account is created by the borrower in favour of the lender or collateral agent. This pledge must be ratified before a Mexican public attester and registered with the Sole Registry of Liens over Movable Assets.

Due Diligence

A comprehensive due diligence process for the financed assets is essential for the proper structuring of financing and the drafting of credit documents. This process includes a detailed review of lease agreements. Lenders and their advisers

need to have a clear understanding of various concepts, as outlined below.

Title deed

Verification of title ownership and proper registration in the public registry of property.

Lease agreements

Examination of lease terms and conditions, including construction phases, rent payments, tenant rights and options, and termination events.

Existing liens

In acquisition financing, it is common for the stabilised assets to be acquired to be mortgaged or form part of a security trust estate created for the benefit of the seller's creditors. Co-ordination with the seller's lenders is necessary, and a review of payoff letters and release and termination documents must be conducted prior to closing. The existence of liens is confirmed through lien certificates issued by the local public registry of property.

Preventive notice

In many Mexican states, the issuance of a preventive notice is required before the transfer of real estate property or the creation of a lien on it. This notice is requested by the notary public designated for the transaction and, together with the lien certificate, reserves the relevant property for a specific period to complete the required action before the corresponding notary public.

Tenants' preferential rights

Mexican state laws grant tenants preferential rights to acquire leased property in case of a sale. In acquisition financing, it is important to obtain properly documented waivers of tenants' preferential rights before closing. If the property is in a condominium, a review of local condominium laws and applicable condominium regulations is necessary to determine if other condominium unit owners have any preferential rights that need to be waived.

Construction and environmental permits

Construction and environmental permits from governmental authorities should be obtained before the first disbursement of a construction facility.

Governmental authorisations in acquisition financing

Depending on the transaction's amount and the location of the financed assets, the borrower may require prior authorisations from antitrust authorities or municipal authorities overseeing urban development.

Property taxes and water services

Lenders should receive evidence of payment of local property taxes and utilities. The existence of outstanding amounts owed to local authorities may hinder or delay the registration of the lien in favour of the lender with the local public registry.

Insurance

Insurance policies covering stabilised property or its construction should be in place, with coverage meeting the lenders' and their insurance advisers' requirements. The lender or collateral agent is typically designated as an additional insured party.

Financial Ratios and Mandatory Prepayments

Financial ratios

Typical financial covenants included in the credit agreement measure various aspects, including:

- the principal outstanding amount of the loan in relation to the value of the stabilised indus-

trial property, determined by an independent appraiser acceptable to the lenders;
- the net operating income generated by rent payments during a calculation period (eg, the last 12 months) in relation to the debt service paid during that period;
- in construction facilities, the principal outstanding amount of the loan in relation to the project's cost, which is validated by an independent supervisor; and
- the net operating income generated by rent payments during a calculation period in relation to the principal outstanding amount of the loan.

Reporting covenants should provide lenders with access to the necessary information to measure the performance of financial covenants with appropriate periodicity. These covenants should typically include monthly or quarterly rent roll reports and regulations for the delivery of new appraisals of real estate assets.

Mandatory prepayments

The credit agreement usually outlines scenarios that trigger mandatory prepayments. Common triggers include:

- application of insurance proceeds resulting from property damage;
- expropriation;
- permitted sales of a portion of the properties comprising a financed portfolio; and
- a reduction in the debt service coverage ratio.

MOROCCO

Law and Practice

Contributed by:
Alain Gauvin and Kawtar Raji-Briand
Gauvin & Raji Avocats

Contents

Gauvin & Raji Avocats specialises in the banking and financial sector, with offices in Paris and Casablanca. The firm helps to prepare and draft legal and regulatory reforms and advises its public and private clients, in connection with banking and financial regulation, the structuring of innovative financial instruments, and the creation of financial institutions and sovereign or private investment funds, as well as financial and insurance risk transfer vehicles. Gauvin & Raji Avocats maintains close working relationships with the governments of the countries in which it operates, as well as with professional associations. It assists its clients with the implementation of their projects in several European countries as well as in Africa. The firm's goal is to foster relations between the European Union and the African Union. It also assists and represents its clients in other regions of the world where the development of their activities is complicated by various risks, including geopolitical risks.

Authors

Alain Gauvin has been advising clients, governments and operators in the banking, financial and insurance sectors for more than 25 years on regulations, relations with supervisory authorities, creation of financial institutions, product structuring, litigation, market operations (financial futures, temporary transfer of securities), crypto-assets, structuring of investment funds, risk management and transfer instruments, creation of sovereign funds (AFRICA50) and private funds, and financing (corporate, assets, documentary credits). He is a conference speaker and has written many articles on financial law topics. His latest book, published on 14 January 2021 (by the publisher Banque), deals with Moroccan banking law.

Kawtar Raji-Briand worked as a lawyer for Transparency International before collaborating with international firms in Europe and Africa. She was a member of the Commission of Free Trade Agreements, Trade Agreements and EU of the CGEM (Moroccan employers' association). She is the Secretary General of the Moroccan Association of Exporters (ASMEX); she also chairs the Legal Commission. Kawtar has contributed to the structuring and restructuring of sovereign funds (Africa50, FGIS, FSRG, FSM). In Islamic finance, she has contributed to the structuring and negotiation of Sharia-compliant products (murabaha, mucharaka, ijara, tawarruk, guarantees, istisnaa, syndication, etc) and to the setting up of Sharia-compliant market infrastructures (teleclearing, funds, etc).

Gauvin & Raji Avocats

Twin Towers 5th Floor
Bd. Zerktouni
Bd. Al Massira
Casablanca
Morocco

Tel: +212 661 96 97 67
+212 661 20 86 54
Email: agauvin@gauvin-avocats.com
kraji@gauvin-avocats.com;
Web: gauvin-avocats.com/en

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

The recent surge in raw material prices and supply difficulties are having serious repercussions on the economy and disrupting the daily lives of households and businesses. Several companies are facing cash flow tensions, under the effect of an economic crisis which, following COVID, has been prolonged by the war in Ukraine and accentuated by the expiry of cash credits guaranteed by the State at the start of the year, in addition to an extension of payment deadlines.

In addition, companies must face another challenge: the drought observed in Morocco, with recent precipitation estimated at only 13% of the typical annual average and dam levels at below a third of their capacity, which is compromising the 2021-2022 agricultural campaign and poses a serious risk of rural exodus similar to that which was experienced in the 1980s.

Faced with this, the government has renewed its support for businesses through a system implemented by banks. In practical terms, this system consists of the following measures:

- Tamwilcom, a state-backed financing initiative for Moroccan businesses, has increased its guarantee commitment ceiling from MAD10 million per operation and MAD20 million for the same company (Damane Atassyir and Damane Istitmar) to MAD15 million and MAD30 million respectively, in order for companies to cover financing of up to MAD50 million compared to MAD33 million previously; and
- new debt rescheduling operations, up to three years including a deferral of up to one year to ease pressure on cash flow, are available to companies, and after agreement from the creditor bank, to companies not in a situation of safeguarding, recovery or judicial liquidation. The same extension period must be applied to other medium and long-term loans granted by the bank. In return for this aid, companies undertake not to distribute dividends nor to remunerate or reimburse the current accounts of partners during the deferral period for rescheduled credits.

Furthermore, in response to the exceptional rise in inflation in 2022, the Moroccan central bank, Bank Al-Maghrib (BAM), raised its key rate twice, in September and December, by 100 basis points in total, while maintaining all other support measures put in place in 2020 in response to the COVID-19 crisis.

However, interest rates did not experience significant variations, with the exception of those matching Treasury issues. At the same time, bank credit to the non-financial sector recorded an increase of 7.9%, mainly reflecting the increase in cash flow needs of private companies.

Monetary conditions were also marked by an annual average depreciation of the real effective exchange rate of 4%.

On 3 April 2023, the International Monetary Fund (IMF) approved a two-year agreement in favour of Morocco under the Flexible Credit Line (*ligne de crédit modulable*, or LCM), designed for crisis prevention, amounting to approximately USD5 billion. The IMF considered that Morocco met the conditions required to benefit from this LCM due to its solid economic policies, institutional frameworks and economic fundamentals, as well as its commitment to maintaining these policies in the future.

However, the Moroccan economy remains vulnerable to a deterioration in the global economic and financial environment, increased volatility in commodity prices and recurrent droughts. In this context, the LCM agreement will strengthen Morocco's external reserves and provide the country with additional insurance against extreme risks.

1.2 Impact of the Ukraine War

Please refer to **1.1 The Regulatory Environment and Economic Background**.

1.3 The High-Yield Market

The Moroccan corporate bond market features a wide range of opportunities for investors, mainly with the banking and financial sector, commodities and infrastructure companies, food and beverage manufacturers and industrials as issuers. The Moroccan banking sector includes both state-owned banks (eg, CDG Group) and private banks (eg, Attijariwafa bank, Bank of Africa, CFG Bank, etc). It should be noted that foreign banks are still present in Morocco (eg, Société Générale and BNP Paribas) even though the trend of moving away from Africa seems to be growing: for example, Crédit Agricole recently sold its Moroccan banking subsidiary (Crédit du Maroc) to a large Moroccan private conglomerate; this, after having sold its African banking subsidiaries to the Moroccan banking leader, Attijariwafa bank, some 15 years ago.

The financials of Moroccan corporate and banking bonds seem to be reliable in terms of credit fundamentals partly thanks to the careful supervision conducted by BAM and the Moroccan capital markets authority, the Autorité Marocaine du Marché des Capitaux (AMMC). BAM and the foreign exchange office, the Office des Changes, have elaborated and implemented strict capital requirements and controls on the exposure of Moroccan banks to foreign exchange for the purpose of establishing a certain level of control over potential risks. Moreover, Moroccan banks and companies tend to be conservative, avoiding anything that is likely to negatively impact the health of their balance sheets, which can be seen in the relatively low rates of average leverage. This quite low leverage ratio may trans-

late into a potential for investment choices with appealing risk/return characteristics.

1.4 Alternative Credit Providers

Almost the total amount of credit extended to Moroccan borrowers was made available by banks, including international financial institutions (IFIs). It is worth mentioning that the Kingdom of Morocco has been for a long time and is still the first "client" of most of these IFIs, notably the African Development Bank (AfDB) and the Agence Française de Développement (AFD). Some of the total credit extended to Moroccan borrowers was made available by financial leasing companies, factoring companies and financing companies in the market.

Hence, banks remain dominant in the credit sector, even though factoring, financial leasing and financing companies and funds are strengthening their position and alternatives to banks are trying to emerge.

1.5 Banking and Finance Techniques

Ways in which banking and finance techniques are evolving include:

Facilitating the use of financing by the capital market

The AMMC has contributed to the establishment of a modern, flexible and evolving legislative and regulatory framework likely to encourage the financing of companies by the market, thanks to:

- the amendment of the AMMC circular on financial transactions and information on 22 December 2020, introducing in particular an extension of the definition of qualified investor (*investisseur qualifié*) (i) to the subsidiaries of persons meeting the criteria, allowing them to benefit, on request, from this status of qualified investor, as well as (ii) to both the deposit guarantee funds (www.ammc.ma/fr/actualites/circulaire-de-lammc-ndeg0220-du-22-decembre-2020-completant-et-modifiant-et-completant);
- the finalisation of the AMMC circular on financial investment advisers (*conseils en investissements financiers*) on 18 January 2023, making it possible to regulate the activity of advising investors and issuers through rules of registration, professional practice and ethics (www.ammc.ma/sites/default/files/Circulaire%20AMMC%20n%C2%B020-01%20relative%20aux%20Conseillers%20en%20Investissement%20Financier.pdf); and
- support, on 8 July 2022, for the operationalisation of the latest amendment to the law on public limited companies, concerning measures to strengthen the governance of issuers and the protection of investors (www.ammc.ma/sites/default/files/Code_APE_2021_0.pdf).

Promoting the creation and implementation of innovative products

To support innovation, the AMMC carried out several actions in 2022 and 2023 to enhance the range of financial instruments available on the market, in particular:

- finalising the regulatory mechanism governing collaborative financing;
- expanding the Sharia-compliant finance (*finance participative*) offering, through the adoption of decrees relating to investment and financing Sukuk certificates and the presentation to the Supreme Council of the Ulemas of a Sharia-compliant stock market index project; and
- supporting the development of fintech by adopting a multidimensional approach through:
  (a) launching a proof of concept using blockchain technology in close collaboration

with certain market players and relating to a bond issue by private placement, thus representing the first bond issue launched in Morocco on a blockchain platform;
(b) implementing the legislative framework for crypto-assets by overseeing a national working group on crypto-assets (GTNCA); and
(c) launching a fintech portal on the AMMC website to allow project leaders to discuss their projects and the legal and regulatory framework applicable to them with the AMMC.

1.6 ESG/Sustainability-Linked Lending

Environmental, social, corporate and governance (ESG) issues are on the agenda of the Moroccan government and authorities such as the AMMC and BAM.

Sustainable finance

Over the years, Morocco has been undertaking a remarkable sustainability strategy, focusing particularly on renewables, in accordance with the ever-increasing energy demand of the country. Since the early 2000s, Morocco has invested massively, with the support of IFIs, in renewable energy projects, and the renewable energy capacity in the country has enjoyed a tremendous increase.

Furthermore, BAM has mobilised, alongside ministerial authorities, to achieve the nationally determined contributions under the Paris Agreement by establishing a favourable and incentive regulatory framework and is working with the authorities concerned to define the national Net Zero carbon strategy by 2050.

From the international standpoint, BAM has contributed to the work of the central banks involved in the Network for Greening the Financial System (www.ngfs.net/en), the Sustainable Banking and Finance Network (www.sbfnetwork.org) and the Alliance for Financial Inclusion (www.afi-global.org) in the field of green and sustainable finance.

The AMMC continued its commitment to the development of sustainable finance through a series of actions aimed at promoting the integration of sustainability aspects into the practices of market players, both issuers and market participants. Similarly, the AMMC has signed partnership agreements (FSD Africa, IFC – fsdafrica.org/partner-organisation/ifc), carried out awareness-raising actions on ESG aspects and deployed a tool to assess the compliance and quality of ESG reports. In addition, the AMMC and the Casablanca Stock Exchange organised a meeting of the signatories of the Marrakech Pledge launched at COP22. This meeting was an opportunity to reflect upon the achievements of this initiative, to deliberate on a new action plan and to welcome six new signatories (three stock exchanges and three capital market authorities).

Customer protection

BAM continued work aimed at strengthening transparency and the public's right to information, improving access to banking products and services, stimulating competition for the benefit of users and developing the complaints management system. In this context, BAM has issued texts on information for credit applicants and account closure. In connection with the processing of complaints, it continued its policy of promoting the Moroccan Centre for Banking Mediation (cmmb.ma/en), notably through its support in the context of targeted communication actions and encouraging users of banking services to use its services for the amicable settlement of disputes.

Supporting women

BAM has always been aware of the obstacles encountered by rural women, who remain among the most vulnerable segments of the population in terms of financial inclusion. For this reason, BAM worked to mobilise public and private actors for the development of a national road map in favour of their economic empowerment. To this end, a support mission has been carried out, with the support of the European Bank for Reconstruction and Development (EBRD), with the aim of assisting in the furtherance of this vast project.

2. Authorisation

2.1 Providing Financing to a Company

The so-called "banking monopoly" is a principle of Moroccan law that prohibits any entity from carrying out credit operations on a regular basis other than those expressly authorised to do so. Entities that carry out credit activities on a regular basis must be either a licensed credit institution (*établissement de credit*) or a financing entity (*société de financement*). Before carrying out their credit activities in Morocco, those entities must be licensed by the Wali (governor) of BAM and comply with the relevant prerequisites and conditions.

Moroccan laws provide, however, for some exceptions to the banking monopoly, amongst which are:

- loans granted by individuals to enterprises via crowdfunding platforms;
- commercial loans between enterprises that have an economic relationship;
- intragroup loans; and
- securitisation vehicles (*organismes de titrisation*).

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Foreign lenders are subject to the Moroccan rules on banking monopoly except for international financial institutions and foreign public co-operation bodies authorised under an agreement entered into with Morocco to grant loans to Moroccan entities.

Besides, foreign lenders are subject to the Moroccan foreign exchange regulations, mainly the Instruction Générale des Opérations de Change (IGOC), which lays down certain conditions in terms of purpose of financing.

In practice, foreign lenders are commonly involved in granting syndicated loans to Moroccan corporates, many of which go towards the funding of infrastructure projects.

3.2 Restrictions on Foreign Lenders Receiving Security

The granting of securities to foreign lenders is subject to the Moroccan foreign exchange regulations. Moroccan banks are allowed to grant securities to foreign lenders to cover commitments to the latter, under the conditions set out in the IGOC. The IGOC also refers to margin calls and cash deposits provided as collateral under commodity derivatives.

Finally, Moroccan insolvency laws may restrict the possibilities of providing security.

3.3 Restrictions and Controls on Foreign Currency Exchange

Morocco is subject to foreign exchange controls and regulation. Foreign investors are allowed, following the completion of some formalities, to freely transfer abroad the whole proceeds of their

investments in Morocco provided that the initial investment is carried in one of the foreign currencies listed by BAM. Furthermore, payments abroad of principal, interest, fees and commissions due under eligible loans are authorised.

However, some specific transfers of funds into and out of Morocco are subject to prior authorisations from the Office des Changes.

3.4 Restrictions on the Borrower's Use of Proceeds

There are no specific statutory restrictions on a Moroccan borrower's use of proceeds from loans or debt securities under Moroccan laws. Parties do, however, generally agree contractually on the permitted use of funds.

3.5 Agent and Trust Concepts

The concept of agent is largely used in Morocco in the course of syndicated loans. It is generally based on a power of attorney granted by the lenders to a bank institution acting as agent, based on the agency provisions included in the *Dahir (9 Ramadan 1331) formant Code des Obligations et des Contrats (BO 12 Septembre 1913)* (DOC) and Commercial Code (*Loi No. 15-95 formant code de commerce*). Creditors are expressly authorised by the DOC to appoint a pledge agent to manage their securities on their behalf, from their creation to their enforcement.

There is no concept of a trust under Moroccan laws.

3.6 Loan Transfer Mechanisms

Transfer of monetary claims (*créances*) under a facility agreement subject to Moroccan laws can be made by way of an assignment (*cession*) that might be subject to:

- the DOC, which requires a notification to the borrower by bailiff or the borrower's consent in case of litigious claims;
- the Commercial Code, which allows assignment to banks licensed by the Wali of BAM; or
- Securitisation Law No. 33-06 as subsequently amended and completed by Laws No. 119-12, 05-14 and 69-17.

The assignment agreement is executed between the existing lender and the new lender without the necessity of having the borrower as a party. Notification to the borrower, however, is required to make the assignment effective towards the borrower.

The transfer of security packages may require the authorising entity to grant the respective collateral, as well as the conduct of additional formalities, such as filings with regulatory and registration authorities (L'Agence Nationale de la Conservation Foncière, Registre National Electronique des Sûretés Mobilières, etc).

3.7 Debt Buy-Back

There are no specific restrictions on debt buy-back by the borrower under Moroccan laws.

3.8 Public Acquisition Finance

The Moroccan legal framework regarding takeover bids is provided in *Loi No. 26-03 relative aux offres publiques sur le marché boursier*, *Loi No. 17-95 relative aux sociétés anonymes* and the *Règlement Général de la Bourse de Casablanca*. Takeover bids are governed by the rules of equality between shareholders and free competition. There are no rules regarding "certain funds" with respect to public acquisition finance transactions. Under Moroccan law, in public acquisition finance, the bidder in a takeover bid is required to guarantee to the holders of the

shares of the targeted company that it will fully pay their purchase price.

3.9 Recent Legal and Commercial Developments

Two legal developments deserve to be pointed out:

- Due to the effect of COVID, parties are inclined to amend the clause governing force majeure with a view to, depending on the respective parties' standpoints, capturing or excluding events like the COVID pandemic.
- Before 28 July 2022, the text setting out the list of regulated assets that insurance companies can hold in representation of their technical reserves – namely, article 27 of the Order of the Minister of Finance and Privatisation No. 1548-05 of 10 October 2005 relating to insurance and reinsurance companies, modified by Order No. 3120-10 of 16 November 2010 – did not in any way contemplate securities governed under foreign law. Since then, the doubt has been removed insofar as article 38 of Circular No. 01/AS/19 of 2 January 2019 has been amended by Circular No. AS/01/21 of 16 March 2021, published (only in Arabic) on 28 July 2022. Consequently, legal advice opining on the capacity of insurance companies to subscribe to foreign rights securities must be reviewed, and the contracts between banks and insurers intended to market such securities to the latter may be amended.

3.10 Usury Laws

Banking Law No. 103-12 as amended in 2021 allows the Minister of Finance to fix the maximum amount of interest that may be charged by banks and financial institutions. The maximum amount fixed for the period from 1 April 2023 to 31 March 2024 is 12.94%.

3.11 Disclosure Requirements

There are no rules or laws regarding disclosure of certain financial contracts.

4. Tax

4.1 Withholding Tax

Payment of the principal is not subject to taxation.

Interest payments paid overseas to entities that are non-resident lenders are subject to withholding tax at a rate of 10%, subject to any double taxation treaty which may provide for a lower withholding tax rate or an exemption from tax.

There should be no obligation on the payor to withhold tax at source upon the payment of interest to a foreign lender if:

- the loan is a granted by a foreign lender to the Moroccan State or is guaranteed by the latter;
- the loan is granted by the Banque Européenne d'Investissement for projects approved by the Moroccan Government;
- the loan is granted by the AfDB, the Islamic Development Bank or the International Finance Corporation; or
- the loan is granted in a foreign currency for a duration of ten years or more.

4.2 Other Taxes, Duties, Charges or Tax Considerations

All agreements concerning property located in Morocco are subject to registration and stamp duties.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Foreign lenders must be aware that VAT issues may arise if their supply of services is deemed to be localised in Morocco.

5. Guarantees and Security

5.1 Assets and Forms of Security

Moroccan law allows for the creation of a wide range of security interests over a broad range of assets. Assets typically available to foreign lenders are real estate, shares, receivables and bank accounts. Foreign lenders are also granted personal guarantees (such as *cautionnements* and first-demand guarantees).

The mortgage deed must be signed before a Moroccan notary (*notaire*) in order to be valid. The pledge may be established by notarial deed or by private deed. Non-possessory pledges shall be registered with the National Electronic Registry of Moveable Security Rights (Registre National Electronique des Sûretés Mobilières).

Under the Commercial Code, different regimes exist for pledge of goodwill, non-possessory pledge over tools and equipment, etc, subject to observation of the relevant perfection requirements.

5.2 Floating Charges and/or Similar Security Interests

The concept of floating charges does not exist under Moroccan law. Rather, security arrangements are made with respect to each and every asset and type of asset, subject to observation of the relevant perfection requirements.

5.3 Downstream, Upstream and Cross-Stream Guarantees

Moroccan law does not restrict downstream guarantees. The law expressly authorises a Moroccan company in the form of a *société anonyme* to grant guarantees or securities to secure bonds issued by its subsidiaries. On the contrary, a company in the form of a *société à responsabilité limitée* cannot grant guarantees to secure bonds or other negotiable securities.

The granting of upstream and cross-stream guarantees must not impair the company's corporate benefit, nor infringe any statutory objects provisions or prohibition on using the corporate assets wrongfully.

5.4 Restrictions on the Target

A Moroccan company in the forme of a *société anonyme* cannot grant any financial assistance in the form of a guarantee or a loan for the acquisition of its own shares by a third party.

5.5 Other Restrictions

A guarantee granted or given by a Moroccan company in the form of a *société anonyme* requires an approval from its board of directors unless the managing director is provided with a delegation of authority within a fixed limit.

5.6 Release of Typical Forms of Security

Modalities of the release of security depend on the type of security that has been granted.

Pledges and *cautionnements* will automatically lapse in the event of a full satisfaction of the secured liabilities. Non-possessory pledges registered with the Registre National Electronique des Sûretés Mobilières require the filing of a release notice in that register.

The release of mortgages is subject to formal requirements in order for the relevant security right to be released from the land register.

5.7 Rules Governing the Priority of Competing Security Interests

The priority of competing security interests is regulated by the DOC. Generally, privileges rank in priority over any other security and, among themselves, rank according to the particular nature of the debt as established by law.

A pledge confers on the creditor the right to be paid on the pledged asset in preference to all other creditors, in the case of the debtor's failure to pay.

Non-possessory pledges rank among themselves, according to their date of registration in the Registre National Electronique des Sûretés Mobilières.

Contractual subordination is commonly used even though there are no specific provisions under Moroccan law authorising subordination arrangements.

5.8 Priming Liens

The Public Treasury (for tax collection), the Caisse Nationale de Securité Sociale (which is the state-owned fund that grants certain social rights to workers) and workers as regards their salary amounts benefit from a lien, taking priority over secured and unsecured claims.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

A secured lender can enforce the pledged asset when the debtor is in default, subject to formal notice being given to the latter.

The enforcement methods vary according to the security in force. Pledges may be enforced by public sale before the court, or by a judicial attribution of ownership of the pledged property to the creditor, and options allowing a creditor to proceed with the sale of the pledged asset or to become its owner (the so-called *pacte commissoire*), without recourse to judicial intervention, if such an option is provided for contractually.

6.2 Foreign Law and Jurisdiction

The choice of a foreign law as the governing law of the contract or of a foreign jurisdiction will be upheld in Morocco. However, if an application of the foreign law would result in an outcome contrary to Moroccan public order, it can be set aside irrespective of the agreed choice of law.

6.3 Foreign Court Judgments

A foreign judgment or arbitral award against a Moroccan company will be enforceable in Morocco subject to fulfilling the necessary exequatur procedures to recognise that foreign judgment or arbitral award.

6.4 A Foreign Lender's Ability to Enforce Its Rights

As long as security has been created and perfected in accordance with the mandatory laws applicable in Morocco, a foreign lender will ordinarily be able to enforce its rights.

Competent courts may request the loan and security agreement to be translated into Arabic. French translation is tolerated.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

Under Moroccan law, debtors who are insolvent are required to file for a judicial reorganisation proceeding (*redressement judiciaire*) or a compulsory liquidation (*liquidation judiciaire*) in accordance with the provisions of Book V of the Code of Commerce.

The opening of these proceedings will have the following consequences on creditors' rights:

- contractual clauses providing for the automatic termination or acceleration of the contract in the event of reorganisation proceedings are ineffective;
- suspension or prohibition of any legal action by creditors whose claims arose prior to the opening judgment;
- the payment of debts incurred prior to the opening judgment is prohibited;
- interest on loans (and any contractual or statutory interest) as well as all interest for late payment and surcharges will no longer accrue from the date of the judgment opening the proceedings until the date of the judgment adopting the safeguard or continuation plan;
- the commencement of insolvency proceedings does not freeze the enforcement of security but the court may replace the security with any adequate guarantee if the court deems it necessary; and
- creditors must file a statement of their claims (*déclaration de créances*) against the debtor within two months (four months for creditors residing out of Morocco) of the date of the publication of the opening judgment in the "bulletin officiel".

7.2 Waterfall of Payments

In bankruptcy proceedings, a debtor's debts are paid in accordance with the Commercial Code in the following order of priority until all available funds have been used:

- creditors that have consented to a new cash contribution to the company in order to ensure its continuation in the framework of a conciliation procedure;
- debts that have arisen regularly after the judgment initiating the safeguard proceedings and that are essential to the continuation of those proceedings or to the activity during the period of preparation of an adequate solution (safeguard, reorganisation, continuation, court-ordered liquidation, etc);
- debts that have arisen regularly after the judgment initiating the judicial reorganisation proceedings and that are essential to the continuation of those proceedings or to the activity during the period of preparation of an adequate solution (safeguard, reorganisation, continuation, court-ordered liquidation, etc);
- secured claims;
- all other unsecured claims (*créances chirographaires*).

7.3 Length of Insolvency Process and Recoveries

Insolvency proceedings in Morocco are widely seen as being complex, slow and inefficient when it comes to collecting debts. Obtaining transparency on restructuring plans may take at least one year. The simplest liquidation proceedings may be settled in a few months, but more complex cases may last over several years (eg,

the liquidation of SAMIR decided in 2016 and still pending).

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

There are two types of reorganisation procedures that are available to the debtor when it is not insolvent (not in a cessation of payments):

- the conciliation procedure (*procédure de conciliation*), which aims to achieve an agreement between the debtor facing financial difficulties and its creditors outside of court. The conciliation agreement is then ratified by the court; and
- the safeguard procedure (*procédure de sauvegarde*), which aims to allow a distressed business to overcome its financial difficulties, guarantee the viability of its activities and discharge its debts in order to avoid an imminent cessation of payments or cash flow insolvency. This involves debt rescheduling, as well as debt write-off, on approval of creditors that have declared their claims. This procedure is fully court-supervised. The court adopts the safeguard plan and may approve the rescheduling and reduction of creditors' claims. The court may also impose uniform payment deadlines on creditors that did not agree to any rescheduling of claims or write-offs (the so-called "non-consenting creditors").

7.5 Risk Areas for Lenders

In addition to the fact that lenders are subject to the priority of payments, transactions concluded and securities granted after a cessation of payments can be declared void by the court.

8. Project Finance

8.1 Recent Project Finance Activity

Project financing is commonly focused on renewable energy, infrastructure and telecommunications projects. The project finance sector in Morocco has been attracting the interest of both local and foreign banks as well as multilateral agencies. The EBRD, the AFD and the AfDB are among those that finance projects in Morocco.

8.2 Public-Private Partnership Transactions

In 2020, Law No. 46-18 of 6 March 2020 amended the legal framework applicable to PPP provided for by Law No. 86-12 of 24 December 2014. Two implementing decrees were published last year. PPP transactions may be commenced by way of solicited or unsolicited proposals.

In December 2022, the PPP Direction of the Minister of Finance published a note setting the guidelines and procedure governing unsolicited proposals allowing a private operator to submit an innovative project to a public entity for implementation.

Also, the report on public establishments and enterprises appended to the 2023 Finance Act provides a summary of PPP projects underway and those in the pipeline. The PPP portfolio covers different activity sectors (health, desalination, irrigation, ports, airports, logistics, social infrastructure, etc).

8.3 Governing Law

In practice, some PPP projects were structured outside the scope of Law No. 86-12 of December 2014 on PPP and as such were subject to foreign law.

8.4 Foreign Ownership

There are generally no restrictions on foreign ownership of Moroccan real property except in very specific cases. For example, Moroccan law prohibits the acquisition by non-Moroccan people of interests in agricultural land outside urban areas without obtaining a certificate of non-agricultural vocation.

Since 2021, acquisition of agricultural land by Moroccan joint-stock companies (*sociétés anonymes*) and partnerships limited by shares (*sociétés en commandite par actions*) is subject to certain conditions.

8.5 Structuring Deals

The key issues to be considered when structuring deals include the following: risk assessment, determining the legal form of the project company and the relevant laws to which those deals are subject as well as the possibility to benefit from any government support or incentive.

There may also be international treaties between the country of residence of the foreign investor and Morocco, which may provide for additional incentives of benefits for certain types of transactions.

8.6 Common Financing Sources and Typical Structures

Typically, project financings are financed as bilateral or club deals (composed of local and foreign lenders).

8.7 Natural Resources

Morocco is home to a range of metals and minerals. Under the Moroccan Mining Code, minerals resources form part of the public domain. As such, in all cases, a licence to explore or extract the resource is required.

That being said, the mining sector has long been and is still dominated by phosphates. OCP SA (a State-owned joint stock company) holds a monopoly over the extraction, transformation and sale of phosphates in the country.

8.8 Environmental, Health and Safety Laws

Since 2015, Morocco has begun to overhaul and update its legal framework for the environment and sustainable development, in accordance with the provisions of framework law No. 99-12 on the national charter and sustainable development. The main environmental laws applicable to projects are:

- Law No. 11-03 on the Protection and Conservation of the Environment;
- Law No. 36-15 on Water;
- Law No. 49-17 on Environmental Assessment;
- Law 28-00 on Waste Management and Disposal;
- The Green Morocco Plan (2008); and
- Law 77-15 (commonly known as the Zero Mika Law).

Furthermore, the Moroccan Labour Code sets out a panoply of provisions governing, among other things, workplace health and safety.

Trends and Developments

Contributed by:
Alain Gauvin and Kawtar Raji-Briand
Gauvin & Raji Avocats

Gauvin & Raji Avocats specialises in the banking and financial sector, with offices in Paris and Casablanca. The firm helps to prepare and draft legal and regulatory reforms and advises its public and private clients, in connection with banking and financial regulation, the structuring of innovative financial instruments, and the creation of financial institutions and sovereign or private investment funds, as well as financial and insurance risk transfer vehicles. Gauvin & Raji Avocats maintains close working relationships with the governments of the countries in which it operates, as well as with professional associations. It assists its clients with the implementation of their projects in several European countries as well as in Africa. The firm's goal is to foster relations between the European Union and the African Union. It also assists and represents its clients in other regions of the world where the development of their activities is complicated by various risks, including geopolitical risks.

Authors

Alain Gauvin has been advising clients, governments and operators in the banking, financial and insurance sectors for more than 25 years on regulations, relations with supervisory authorities, creation of financial institutions, product structuring, litigation, market operations (financial futures, temporary transfer of securities), crypto-assets, structuring of investment funds, risk management and transfer instruments, creation of sovereign funds (AFRICA50) and private funds, and financing (corporate, assets, documentary credits). He is a conference speaker and has written many articles on financial law topics. His latest book, published on 14 January 2021 (by the publisher Banque), deals with Moroccan banking law.

Kawtar Raji-Briand worked as a lawyer for Transparency International before collaborating with international firms in Europe and Africa. She was a member of the Commission of Free Trade Agreements, Trade Agreements and EU of the CGEM (Moroccan employers' association). She is the Secretary General of the Moroccan Association of Exporters (ASMEX); she also chairs the Legal Commission. Kawtar has contributed to the structuring and restructuring of sovereign funds (Africa50, FGIS, FSRG, FSM). In Islamic finance, she has contributed to the structuring and negotiation of Sharia-compliant products (murabaha, mucharaka, ijara, tawarruk, guarantees, istisnaa, syndication, etc) and to the setting up of Sharia-compliant market infrastructures (teleclearing, funds, etc).

Gauvin & Raji Avocats

Twin Towers
5th Floor
Bd. Zerktouni
Bd. Al Massira
Casablanca
Morocco

Tel: +212 661 96 97 67
+212 661 20 86 54
Email: agauvin@gauvin-avocats.com
kraji@gauvin-avocats.com;
Web: gauvin-avocats.com/en

Introduction

For about 15 years, the Moroccan banking and financial sectors have been undergoing profound legal change. To some extent, one can argue that the law has been in advance of (or more mature than) practice. By way of example, the law governing securitisation is a kind of "masterpiece" which is underused, insofar as it seems to be oversophisticated compared to the knowledge of investors; likewise, for ten years now, there has been a law on financial derivatives instruments traded on regulated markets, but no such regulated market has been created so far. On the other hand, one may well point out the lack of laws and regulations that are crucial and of paramount importance for the Kingdom of Morocco, whose ambition is to become a financial centre for the region, meaning North and West Africa.

For the sake of clarity, it is worth distinguishing between the banking sector on the one hand and the financial sector on the other, and we find it interesting to get an overview of these banking and financial markets from both the respective authorities which are in charge of supervising them: Bank Al-Maghrib (BAM – www.bkam.ma) regarding the banking sector and the Moroccan Capital Market Authority (Autorité Marocaine du Marché des Capitaux, or AMMC – www.ammc.ma) regarding the capital markets sector.

Banking Sector

In terms of banking supervision, BAM, which is the central bank of Morocco, has lifted the prudential easing measures taken in the context of COVID-19 and has been continuing its policy aimed at strengthening the resilience of banks and monitoring their exposure to various risks.

Crowdfunding, cloud computing and digitalisation

From the regulatory standpoint, BAM has enacted a framework governing crowdfunding activities and has carried out several important actions aimed at supporting the development of digitalisation of the banking sector.

BAM has supervised the use of cloud computing and the prevention of corruption risks, has enacted several texts to support the launch of crowdfunding instruments and has amended

the texts governing payment institutions for the purpose of supporting the enrolment of agent networks and the network of merchants accepting mobile payments.

BAM has also continued its efforts to support and accelerate the digitalisation of financial services. It has thus contributed, along with the various other players, towards the implementation of the online authentication and identification system for users of banking services and to the development of digital trust services.

Transparency

Furthermore, BAM has actively contributed, along with all players within the banking sector, towards the implementation of the important actions which were crowned by the decision of the Financial Action Task Force (FATF – www.fatf-gafi.org), during its plenary meeting in February 2023, to remove Morocco from the list of Jurisdictions under Increased Monitoring, commonly known as the "grey list". In light of the strength of this progress and due to its enjoying solid economic fundamentals, the Kingdom of Morocco benefited, in April 2023, from a two-year agreement with the International Monetary Fund (IMF) under the Flexible Credit Line (FCL – www.imf.org/en/About/Factsheets/Sheets/2023/Flexible-Credit-Line-FCL), for an amount of about USD5 billion.

Dynamism of Moroccan banks abroad and of the Moroccan market

In 2022, the scope of control of BAM covered a total of 90 credit institutions and similar organisations, distributed between 19 conventional banks, five Sharia-compliant banks (*banques participatives*), 29 finance companies, six offshore banks, 11 microcredit associations, 18 payment establishments, the Deposit and Management Fund (Caisse de Dépôt et de Gestion, or CDG – www.cdg.ma/fr) and the National Guarantee and Business Financing Company (Caisse Centrale de Garantie, or Tamwilcom – www.tamwilcom.ma), the last two being state-owned financial institutions.

From an international perspective, the dynamism of Moroccan banking and financial players deserves to be emphasised: Moroccan banking groups have 51 subsidiaries and 23 branches in 36 countries, including 27 in Africa, seven in Europe and two in Asia. It is also worth mentioning that foreign banking groups are established in Morocco through either a subsidiary, a branch or a representative office.

Promoting women

BAM's objective to promote women within the banking sector is twofold:

- First, women as professionals: BAM has also issued a recommendation to boost the actions of the banking sector in favour of the promotion of women's economic empowerment in order to increase the employment of women as executives.
- Second, women as users of banking services: BAM has been aware of the obstacles encountered by rural women, who remain among the most vulnerable segments of the population in terms of financial inclusion. Therefore, BAM has worked to mobilise public and private actors for the development of a nationwide road map for their economic empowerment. To this end, BAM has carried out a mission with the support of the European Bank for Reconstruction and Development (EBRD – www.ebrd.com), with the purpose of assisting in the furtherance of this vast project.

Net zero carbon by 2050

Furthermore, BAM has mobilised, alongside the ministerial authorities, to achieve the national objectives of contributing to the Paris Agreement (unfccc.int/sites/default/files/english_paris_agreement.pdf) by setting up a favourable and incentivising regulatory framework and is working, with the authorities concerned, to define the national strategy.

At the international level, it has contributed to the work of the central banks involved in the Network for Greening the Financial System (NGFS – www.ngfs.net/en), the Sustainable Banking and Finance Network (SBFN – www.sbfnetwork.org) and the Alliance for Financial Inclusion (AFI – www.afi-global.org) in the field of green and sustainable finance.

Customer protection

As far as customer protection is concerned, BAM has worked to increase the comparability of banking costs and services and enhanced the communication to the public of guides and useful information on these services and the rights and obligations in this area.

Furthermore, BAM keeps on working at strengthening transparency and the public's right to information, improving access to banking products and services, stimulating competition for the benefit of customers and developing the complaints management system. In this context, BAM has enacted texts governing the information given to clients soliciting banks for loans. BAM is also increasing banks' duties with respect to the closing of accounts.

As part of the processing of complaints, it has been continuing its policy of promoting the Moroccan Centre for Banking Mediation (Centre Marocain de Médiation Bancaire – cmmb.ma), in particular, through its support with targeted communication actions and encouraging users of banking services to use its services, in connection with the amicable settlement of disputes.

Capital Markets Sector

In 2021, the AMMC presented its three-year Strategic Plan 2021-2023 (www.ammc.ma/fr/ammc/plan-strategique) with the major ambition of promoting the capital markets as a tool for the financing of economic recovery. Through this second strategic plan, the AMMC provides strong support measures capable of initiating a recovery dynamic. This strategic plan is based on four main pillars:

- facilitating the use of capital market financing;
- promoting regulation adapted and contributing to innovation;
- strengthening the protection of savings by consolidating the new supervision approach; and
- accelerating the modernisation of the AMMC and including it in a digital transformation process.

In 2021, the AMMC also introduced the annual publication of its priority actions (www.ammc.ma/sites/default/files/2023-02/Actions%20Prioritaires%202023.pdf), which obliges the authority to take into account changes in its environment and the progress made. These annual priorities are the subject of discussions between the AMMC and market players to better meet the expectations of the latter, while respecting, of course, the general interest.

Facilitating the use of financing by the capital markets

The AMMC has contributed to the establishment of a modern, flexible and evolving legislative and

regulatory framework likely to encourage the financing of companies by the market, thanks to:

- amending the AMMC circular on financial transactions and information, introducing in particular an extension of the definition of qualified investor (i) to the subsidiaries of entities meeting the criteria allowing them to benefit, on request, from the status of qualified investor, as well as (ii) to both the deposit guarantee funds;
- finalising the AMMC circular on financial investment advisers (*conseillers en investissements financiers*), making it possible to regulate the activity of advising investors and issuers through rules of registration, professional practice and ethics; and
- supporting the operationalisation of the latest amendment to the law on public limited companies, concerning measures to strengthen the governance of issuers and the protection of investors.

Promoting the creation and implementation of innovative products

Supporting innovation, the AMMC carried out several actions in 2022 to enrich the range of financial instruments available on the market, in particular:

- finalising the regulatory mechanism governing collaborative financing;
- expanding the Sharia-compliant finance (*finance participative*) offering, through the adoption of decrees relating to investment and financing Sukuk certificates and the presentation to the Supreme Council of the Ulemas (Conseil Supérieur des Oulémas, or CSO) of a Sharia-compliant stock market index project;
- supporting the development of the fintech sector by adopting a multidimensional approach, through:
  (a) launching a proof of concept using blockchain technology in close collaboration with certain market players and relating to a bond issue by private placement, thus representing the first bond issue ever launched in Morocco on a blockchain platform;
  (b) implementing the legislative framework for crypto-assets by overseeing a national working group on crypto-assets (GTNCA);
  (c) launching a fintech portal on the AMMC website to allow project leaders to discuss their projects and the legal and regulatory framework applicable to them with the AMMC.

Pursuing actions in favour of sustainable finance

The AMMC has been continuing its commitment to the development of sustainable finance through a series of actions aimed at promoting the integration of sustainability aspects into the practices of market players, both issuers and market participants. Similarly, the AMMC has signed partnership agreements (FSD Africa, IFC – fsdafrica.org/partner-organisation/ifc), carried out awareness-raising actions on ESG (environment, social and governance) aspects and deployed a tool to assess the compliance and quality of ESG reports. In addition, the AMMC and the Casablanca Stock Exchange organised a meeting of the signatories of the "Marrakech Pledge" for "fostering green capital markets in Africa" launched at COP22 (marrakechpledge.com). This meeting was an opportunity to reflect upon the achievements of this initiative, stimulate consideration of a new action plan and welcome six new signatories (three stock exchanges and three capital market regulators).

Educating the general public about capital markets

The AMMC gives pride of place to financial education actions aimed at the general public, in particular individuals. In this context, the AMMC launched its communication strategy for the general public and improved the scope of its actions aimed at the public by utilising new communication methods (radio campaigns, info sheets and educational videos: www.ammc.ma).

Controlling risks by disseminating good practices through digitalisation

The consolidation of the new supervision approach for the protection of savings is a pillar of the 2021-2023 AMMC Strategic Plan. The past two years have seen an intensification of controls and an increase in the coverage rate, which reached 97% in 2022 as against 50% in 2021. The 2021-2022 period was marked by the completion of 35 inspection missions, an increase of 94% compared to the 2019-2020 period. In terms of anti-money laundering and countering the financing of terrorism (AML & CFT), the AMMC has updated its circular on the duty of vigilance and has strengthened its approach to raising awareness and supporting market players. It now bases its controls on the risk mapping established in 2021 and the national risk assessment, thus ensuring the technical compliance and effectiveness of the AML & CFT system of market participants with regard to the standards of the FATF and the Financial Action Task Force of Middle East and North Africa (FATFMENA). Finally, in the fight against corruption, the AMMC, in close collaboration with the National Authority for Probity, Prevention and the Fight against Corruption (Instance Nationale de la Probité, de la Prévention et de la Lutte contre la Corruption, or INPPLC – www.inpplc.ma/fr), carried out actions to raise awareness among market players and has published, jointly with this body and the other regulators (BAM and the Supervisory Authority of Insurance and Social Welfare (Autorité de Contrôle des Assurances et de la Prévoyance Sociale, or ACAPS – www.acaps.ma), which is the Moroccan authority supervising the insurance market), a guide against corruption intended for professionals.

NORWAY

Law and Practice

Contributed by:
Ida Marie Windrup, Audun Nedrelid, Magnus Tønseth and Markus Nilssen
Advokatfirmaet BAHR AS

Contents

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Advokatfirmaet BAHR AS

Advokatfirmaet BAHR AS was established in 1966 and serves as adviser, problem solver and partner in strategic discussions for Norwegian clients in domestic or international matters, as well as foreign players facing opportunities or challenges in Norway. BAHR offers all business-related legal disciplines, with offices in Oslo and Bergen, and around 200 fee earners. The firm's banking and finance team combines industry understanding and tier-1 legal capabilities to enable value-maximising transactions for its clients. Recent deals include acting for seafood giant SalMar in relation to its unsecured debt facilities totalling NOK16 billion. BAHR also acted on behalf of the banks, in relation to financing of NOK4.2 billion for debt collection group Kredinor, in connection with Kredinor's cross-border merger with the Modhi group. As part of BAHR's cutting-edge approach, former long-term partner at Pareto Securities, Stian Winther joined BAHR's Banking and Finance team as strategic advisor, to strengthen the team's ability to deliver tailored and innovative legal advice to its clients.

Authors

Ida Marie Windrup is a partner at BAHR and heads up its debt capital markets group, which includes the banking and finance team. Ida advises leading Norwegian and international banking and investment clients on debt financing transactions, with a focus on secured asset, project and acquisition financing transactions. Ida works across a variety of sectors and industries, including infrastructure and technology, as well as ocean-related industries. She is dual qualified as a Norwegian advokat and an English solicitor.

Audun Nedrelid is a debt capital markets financing specialist, working both within the banking and bond markets. He regularly acts for issuers and borrowers, advising both major corporate clients and private equity clients on some of their most substantial transactions. Such transactions fall within both traditional bank lending and capital markets issues of bonds, as well as other private placement debt. His experience ranges from corporate loans for blue chip borrowers, asset-based financings (with a particular emphasis on shipping and offshore loans, as well as infrastructure financings) and leveraged/acquisition financings to combined bank and bond or direct lending structures with appurtenant intercreditor issues.

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Advokatfirmaet BAHR AS

Magnus Tønseth advises creditors and debtors on restructuring and debt financing, including bank and bond financing. Magnus has been responsible for leading BAHR's work on several high-profile, complex cross-border processes over recent years, to include processes both in and out of court, Norwegian and international. Magnus has broad experience with cross-border bank and bond financing structures across a range of different industry sectors, including telecoms, renewable energy, NPL, shipping and offshore.

Markus Nilssen is a capital markets lawyer with a particular focus on financial regulation. He advises clients on various regulatory matters and corporate finance transactions in the DCM and ECM markets. Markus is an expert on Norwegian covered bonds legislation and regularly acts for several of Norway's largest covered bond issuers. He also has a broad experience, ranging from advising on various types of corporate and financial arrangements and transactions (including securitisation and other structured finance transactions) to factoring, public M&A, corporate restructurings and general corporate finance work.

Advokatfirmaet BAHR AS

Tjuvholmen allé 16,
NO-0252 Oslo,
Norway

Tel: +47 21 00 00 50
Email: post@bahr.no
Web: www.bahr.no

BAHR

Contributed by: Ida Marie Windrup, Audun Nedrelid, Magnus Tønseth and Markus Nilssen,
Advokatfirmaet BAHR AS

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Like the rest of Europe, from 2021 to present, Norway has seen a shift from record-high financing activity to a high-inflation environment with rising interest rates. In 2023, there was less activity in the Norwegian debt capital markets, largely due to uncertainties on a macro level and the geopolitical situation. In particular, the energy crisis was the focal point of investors and banks alike. This facilitated a slight shift from the ESG-driven deals pursued in 2021 and early 2022, to some investors and banks reconsidering their exit from the oil and oil services industry, with some even re-entering that market after having divested some years prior. Whilst banks have remained relatively cautious in the last 12 months, there has been a rise in activity towards the end of the second quarter of 2023. Despite this, lending into the commercial real estate sector has remained particularly modest and is expected to remain so in the months to come. On the regulatory side, Norway continues to adopt EU financial regulations but is still lagging behind on a number of key pieces of legislation, such the securitisation regulation and PRIIPs.

1.2 Impact of the Ukraine War

The scarcity of energy in Europe has resulted in growing appetite for financing offshore and oil services (after several years of banks exiting the sectors), both in Norway and in Europe generally. European banks and investors have started lending to the sector again in the name of energy security. Driven to some extent by the same concern, but also continuing an existing trend, financing of LNG and renewable energy has also attracted lenders and investors.

1.3 The High-Yield Market

The Nordic high-yield market has been flavoured by the same trends seen in other capital markets with strong focus on inflation risk, increased interest rates, recession risk and higher energy prices. This has affected certain sectors more than others. Commercial real estate is the single largest issuing sector in the Nordic high-yield market. However, higher interest rates have led to asset depreciation and increased funding costs for levered real estate issuers, which in turn has led to a downward spiral of rating downgrades, distressed bond prices and increased default expectations for former household names. Significant amounts are due in the short to medium term, with refinancings for many seeming increasingly difficult.

On the other side of the scale, and once a dominating sector, the market for oil services bonds has seen a new spring this year. Following almost a decade out of favour, secured bonds for drillers and bonds for other subsegments within oil services are now attracting global investor demand at meaningful terms for issuers and investors. Driven by higher oil prices and industry fundamentals with energy security in focus, this is expected to continue if the current market prevails. The high-yield bond market has been an appreciated source of capital for these issuers, especially as the appetite in the conventional bank market has been muted for most.

In general, the issue volume in the Nordic high-yield market as of Q1 of 2023 is on par with full year 2022, which was a rather muted year.

1.4 Alternative Credit Providers

Direct lending is on the rise in Norway. There is naturally limited transparency on statistics within this market in Norway, but based on the authors' observations from transactions, there seems to

be substantial growth, which is expected to continue in the years to come. This is both on a bond format through the templates of the Nordic Trustee and on a more direct and bilateral basis. The format depends both on investor or lender preference and Norwegian regulatory issues, which restrict lending from non-regulated entities (with exceptions as described below).

1.5 Banking and Finance Techniques

Historically, much of the high-volume leveraged or non-investment grade lending in the Norwegian market has been made within capital intensive, asset-backed industry sectors such as shipping and offshore services. Such lending has entailed the financing of expensive assets, which require a capital efficient structure. An early way of raising capital for financing such assets was by way of a two-tiered capital structure, with a first lien bank tranche and a second lien bond tranche in relation to the same asset. A more common structure in recent years has been based on the LMA standard super senior bank or senior secured bond, where in some instances there has also been a senior bank tranche ranking pari passu with the bond tranche. Preferred equity is used extensively, particularly in private equity transactions or in connection with more structured credit. For example, this can be used where several investors are participating in a project but one of the creditors has a regulatory requirement to structure its investment differently from the others. In work-out situations or outright restructurings, issuance of new subordinated capital has often been used instead of equity instruments in order to create a layered capital structure. This may include zero coupon bonds with interest payments akin to that of dividend distributions. Hybrid debt instruments with perpetual tenor have also been used in some instances, to create debt instruments which, for accounting purposes, can count as equity in the balance sheet.

1.6 ESG/Sustainability-Linked Lending

The green and sustainability-linked loan market in Norway has seen a significant boost over the last five years, with around 30% of corporate loans documented by BAHR implementing a sustainability-link mechanism. Both borrowers and lenders are keen on products that reflect their ESG endeavours and it seems there is consensus that a sustainability-linked loan is not about the financial gain so much as it is a licence to operate. The Norwegian legal market closely follows the development in England and in Europe as regards format, with Norwegian banks adopting the sustainability-link rider wording developed by the LMA. Norwegian banks are also developing their own frameworks based on LMA principles, such as green loans where a certain percentage of revenue stems from a “green” activity, service or product. Examples include real estate and aquaculture.

2. Authorisation

2.1 Providing Financing to a Company

The provision of financing (including loans and guarantees) is a regulated activity in Norway, and lenders looking to provide financing to Norwegian companies will, as a starting point, need to be licensed or passported as either an EEA-based credit institution under Directive 2013/36/EU (CRD IV) or a European long-term investment fund under Regulation (EU) 2015/760 (ELTIF). However, loans provided entirely on a Norwegian borrower’s initiative, without the relevant lender having marketed or recommended the loan to the borrower prior to the borrower’s decision to initiate the transaction, may constitute reverse solicitation and not trigger licensing require-

ments in Norway. This is pursuant to the practice and guidelines from the Norwegian regulator. The scope of the reverse solicitation exemption would be subject to a case-by-case analysis.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Other than the licensing requirements mentioned in **2.1 Providing Financing to a Company**, there are no particular restrictions on foreign lenders as opposed to domestic lenders.

3.2 Restrictions on Foreign Lenders Receiving Security

Without prejudice to the licensing requirements for lending activities, there are no restrictions preventing foreign lenders from receiving security or guarantees.

3.3 Restrictions and Controls on Foreign Currency Exchange

Under Norwegian law, there are no foreign currency exchange controls or limits, and there are no restrictions regarding payments or repayments to or from a Norwegian borrower in a foreign currency.

3.4 Restrictions on the Borrower's Use of Proceeds

In general, there are no restrictions on a borrower's use of proceeds from loans or debt securities under Norwegian law. See however **5.4 Restrictions on the Target** regarding the limitations applicable to a Norwegian target company, which relate to supporting an acquirer of a Norwegian target company when it comes to acquisition financing for the purchase of the shares in the Norwegian target company. The same limitations will apply for example with respect to a Norwegian target company obtaining a loan and on-lending these funds to the acquiring entity for the purpose of the acquiring entity paying down its acquisition debt (debt pushdown exercises).

3.5 Agent and Trust Concepts

Norwegian law does not have the concept of "trust" as known in common law or English law, but Norwegian law has a well-established agency concept whereby one entity holds a security interest on behalf of itself and others. With respect to secured financings governed by Norwegian law, a security agent will be appointed by the finance parties to hold the transaction security on their behalf.

3.6 Loan Transfer Mechanisms

Loan agreements governed by Norwegian law generally contain LMA-style provisions facilitating transfers of debt, whereby the transferor agrees to transfer, and the transferee agrees to assume, the debt participation of the transferor. Syndicate lenders usually appoint a security agent to hold and administer the security on their behalf. New lenders will therefore not be required to take any additional steps to obtain the benefit of the associated security. Also, under Norwegian law, the default rule is that the security interest will follow the secured debt, without any further requirements to ensure the continuing effectiveness of the security. This means for example that a syndicate member may sell or otherwise transfer its holding in a syndicated loan, without having to take any further action or formality in order to make sure that transferred loan will retain its benefit from the security interest.

3.7 Debt Buy-Back

Loan agreements may contain provisions which restrict debt buy-back, but in the absence of regulation there are no general restrictions pre-

venting debt buy-back transactions. General equal treatment provisions may be applicable if the debt buy-back relates to traded debt securities.

3.8 Public Acquisition Finance

In private acquisitions, and in voluntary public offers on the Oslo Stock Exchange, it is customary to use the "certain funds" provisions, inspired by the UK Takeover Code, included in an LMA-based facilities agreement. This is in order to provide the seller with the necessary comfort in relation to funds being available to settle the purchase price on closing. In public takeover situations, where a mandatory offer is made on a company listed on the Oslo Stock Exchange, the offeror will need to evidence that a bank or financial institution, which has permission to provide financial services in Norway, has guaranteed settlement of the purchase price.

3.9 Recent Legal and Commercial Developments

A new act regarding financial agreements entered into force in Norway on 1 January 2023, bringing with it certain changes as regards waiver of defences language in Norwegian guarantee and security documents. Logical changes have therefore been introduced to protect the robustness of guarantees and security granted by guarantors and third parties, although it could be argued that the practical effect is negligible.

The unwinding of LIBOR as reference rate has naturally also required changes across the full suite of existing loan transactions under Norwegian law, where the LMA-based wording regarding SOFR and other RFRs has become the market standard.

3.10 Usury Laws

Norway has rules whereby loan terms which are unreasonable as compared to the service provided can be void and not binding on the borrower. However, the rule has had a limited application in practice, and it would normally not come into play in agreements with a professional credit provider. The agreement is generally meant as a safety net and follows from the general contractual principles of Norwegian law relating to non-enforceability of unreasonable contract terms. Applicability of this rule is determined on a case-by-case basis, and there is, for example, no specific interest rate which is the maximum permitted rate under law. Based on comments from credit card providers to the preparatory works and responses from the ministry, the rule would, however, prevent the credit card provider from unreasonably increasing the interest rate towards customers (who already pay a high interest rate on credit card debt) if the credit card provider knows the customer has no alternative ways to refinance the credit card debt.

3.11 Disclosure Requirements

For companies with financial instruments admitted to trading on Oslo Børs, Euronext Expand and Euronext Growth, financial contracts must be publicly disclosed if they constitute inside information pursuant to the EU Market Abuse Regulation. Furthermore, companies with financial instruments admitted to trading on Oslo Børs and Euronext Expand must publicly disclose the issuance of new loans, including any related guarantees or collateral, pursuant to the rules of the Oslo Stock Exchange, regardless of whether this constitutes inside information.

Contributed by: Ida Marie Windrup, Audun Nedrelid, Magnus Tønseth and Markus Nilssen,
Advokatfirmaet BAHR AS

4. Tax

4.1 Withholding Tax

With effect from 1 July 2021 payments from a Norwegian borrower are subject to withholding taxes on payments of interest under loans between certain related parties located in low tax jurisdictions. The purpose of the rule is to prevent profit shifting out of Norway which erodes the basis for the Norwegian tax regime. The withholding tax on interest does not apply to interest payments to non-related lenders, however. Please note that the withholding also applies to some lease payments (thereby ensuring that for capital assets, it is not possible to circumvent the rules by leasing the asset into Norway from a low tax jurisdiction).

4.2 Other Taxes, Duties, Charges or Tax Considerations

In general, Norway is a creditor-friendly jurisdiction when it comes to costs. The withholding tax legislation would not apply to ordinary, third-party lenders and the costs of obtaining security in Norway are limited to nominal registration fees. There are no stamp fees or duties for lenders which are calculated based on the loan amount or the value of the underlying asset.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Such concerns are not relevant in Norway, as the tax rules and withholding tax issues are minimal (as above). Further, FATCA issues are solved by way of information exchange agreements between Norwegian and US authorities. Please note, however, the strict regulatory requirement for lending into Norway, which also limits the role of smaller banks in the Norwegian market (since these banks can at the outset not provide financing into Norway, unless an exception from the licensing requirements can be relied upon).

5. Guarantees and Security

5.1 Assets and Forms of Security

A security package typically consists of:

- a mortgage over any real registered asset being financed, such as real estate, ship, rig, aircraft;
- floating charges over trade receivables, inventory and operating assets;
- a charge over shares in obligors or other relevant companies;
- assignments of insurances and earnings; or
- charge over bank accounts.

The costs of registering security in Norwegian registries are nominal.

Registrable assets are charged by way of a mortgage form, which is registered against the asset in the relevant registry, such as a vessel registered in the Norwegian international ship registry.

Floating charges regarding trade receivables, inventory and operating assets are established by executing a designated charge form which will then need to be registered against the relevant company in the Norwegian Registry of Movable Property. Registration normally takes one to two weeks.

Charges over shares are established by written agreement between the security agent and the shareholder, and (for a private limited company) perfection is established through notice to that company. An updated shareholder registry evidencing the share charge is normally delivered to evidence the share charge and the priority.

Assignments of earnings and receivables, such as insurance proceeds, are created by written

agreement where the act of perfection is notice to debtor.

5.2 Floating Charges and/or Similar Security Interests

All-asset floating charges are not permitted under Norwegian law. A similar effect can be achieved, however, through the establishment of asset-specific floating charges over inventory, machinery and receivables, combined with fixed charges over shares, monetary claims and more.

5.3 Downstream, Upstream and Cross-Stream Guarantees

A Norwegian company may guarantee the debt of its shareholder or another company in the same group of companies as the Norwegian company, provided that the guarantee economically benefits at least one company within its corporate group. This practical exception means that guarantees are common in Norwegian law financings. However, each Norwegian company, in practice through its board of directors, has an obligation to act in the best interests of the company and ensure there is sufficient corporate benefit.

5.4 Restrictions on the Target

A Norwegian target company (and its subsidiaries) may grant security and give a guarantee for the acquisition debt if the company acquiring the shares (buyer) is incorporated in an EEA jurisdiction and will control the target company following the acquisition. A certain whitewash procedure must be complied with prior to the security and/or guarantee being granted, which consists of (among other things) (i) the board of directors of the target considering the creditworthiness of the beneficiary, (ii) approval by the board, (iii) a declaration by the board that it will be in the interest of the company to grant the security and guarantee and (iv) approval by the shareholders of the target (usually by way of shareholder meeting). The package of documents must be filed with the Norwegian Registry of Business Enterprises before the security and guarantee may be granted.

The relevant company will also, in line with granting guarantees and security generally, assess corporate benefit based on the specific facts and situation.

5.5 Other Restrictions

A resolution of the board of directors of the relevant company is normally the only consent required to approve a company's granting of security or guarantees. Shareholder resolutions may be required if provided for in the company's articles of association. There are only nominal registration fees for registering security.

5.6 Release of Typical Forms of Security

Registrable security (such as a mortgage over a vessel and registrable security with the Norwegian Registry of Movable Property) is released through the mortgagee or chargee submitting the original charge form, endorsed with "for deletion" and signed by an authorised signatory of the existing beneficiary (alternatively under a power of attorney). For security perfected through notice to a third party (eg, account banks, debtors and insurance agents etc), the security is released by sending a notice of release or discharge to such third party.

5.7 Rules Governing the Priority of Competing Security Interests

The starting point for priority is that a charge receives priority from the time it obtains legal protection or perfection, so that of competing security is determined based on time of priority ("first in time, best in right"). However, there are significant exceptions. Preferential claims may

also affect priority, although many preferential claims will apply only in the event of insolvency proceedings.

Subordination is a recognised concept under Norwegian law, both contractual and structural, and contractual subordination of claims between creditor groups is standard. The consequences of subordination are not clear cut in all cases, however. For instance, the release mechanism for subordinated claims that may typically be seen in standard LMA intercreditor agreements is untested under Norwegian law. It is believed that subordination under Norwegian law at least extends to turn-over provisions. Whilst in effect this will have the same end result, there is no mentioning of release in the preparatory works to the Norwegian insolvency legislation.

Equitable subordination does not have an equivalent under Norwegian law.

5.8 Priming Liens

Under Norwegian law there are a limited number of security interests arising by operation of law which will prime a lender's security interest. It is not normally possible to structure around such security interests, apart from the mitigating factors mentioned below.

The main priming lien is that the bankruptcy estate of a party (a "Bankrupt Party"), which has encumbered an asset as security for obligations owed, has a statutory lien over any such encumbered asset as well as over assets which a third party has encumbered, as security for the obligations of the Bankrupt Party. An exception applies for assets which are charged as security in accordance with the Norwegian Financial Collateral Act (which implements the Financial Collateral Directive). The statutory lien has priority over all other liens and security interests in the relevant asset, regardless of whether such other liens or security interests have been created voluntarily or involuntarily. However, it is limited to 5% of the value of sales proceeds up to a maximum amount equal to 700 times the court fee at any time (which at present means a maximum amount of NOK870,100) in respect of a mortgage of real property or vessels. Proceeds from the statutory lien (if any) received by the bankruptcy estate may only be applied towards its necessary expenses.

Also, pursuant to the Norwegian Reconstruction Act, a company undergoing reconstruction pursuant to that Act may raise financing for its operations during the reconstruction phase (including for costs related to the reconstruction). Such financing and costs related to the reconstruction will enjoy a statutory lien over the assets of the company undergoing reconstruction and the rules, as set out above in respect of statutory liens for bankruptcy estates, will otherwise be applicable. Assets secured pursuant to the Financial Collateral Act are excluded, however. In addition, the financing and costs related to the reconstruction may be granted a lien over machinery and plant (*driftstilbehør*), inventory (*varelager*) and trade receivables (*utestående fordringer*) of the company with priority over all other liens or security interests in the relevant asset. The debtor must prove that such secured loan is needed, and security may only be granted with the consent of the restructuring committee. Affected holders of security rights may petition the court for the reconstruction committee's consent to be reversed. The court may reverse the consent if the position of the existing security rights is significantly impaired, or if the court finds that there is not a sufficient need for the loan.

Finally, maritime liens will also prime a mortgage over a vessel. Maritime liens will be statutorily preferred, even if the obligation giving rise to the maritime lien arose after perfection of the vessel mortgage.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

The enforcement route under Norwegian law varies based on the asset type.

The Enforcement Act sets out the mandatory provisions for the individual enforcement of security interests over assets such as real estate, vessels, aircrafts and operating assets. Agreements made pre-enforcement, which stipulate alternative enforcement procedures are prohibited, including private repossession or any kind of self-help remedy. However, following an enforcement situation, the security agent and the security provider may agree on alternative enforcement procedures. The main enforcement measures are forced sale through a third party appointed by the court or by public auction.

In order to enforce a claim, the claimant must have sufficient legal grounds for enforcement and perfected (registered) security would in practice constitute grounds for enforcement. In addition, the following must be satisfied: (i) the relevant claim must be due, payable and in default, (ii) the claimant must be entitled to file the petition for enforcement and the claim must be directed at the security provider, and (iii) in relation to perfected security, a written notice must have been served on the security provider two weeks prior to filing a petition for enforcement.

The provisions of the Enforcement Act do not apply in relation to security established pursuant to the Financial Collateral Act (including shares, certain other financial instruments and bank deposits) or security over monetary claims, and instead those security interests may be enforced by self-appropriation and other alternative enforcement procedures agreed between the parties in the relevant security document.

6.2 Foreign Law and Jurisdiction

A Norwegian company may enter into contracts governed by foreign law, and subject to foreign jurisdiction, with the exception that it will usually not be able to circumvent statutory provisions of Norwegian law by choosing foreign law as the governing law.

6.3 Foreign Court Judgments

The courts of Norway will enforce final and conclusive judgments of states party to the Lugano Convention of 2007 and/or obtained in any UK jurisdiction (subject to the terms of the convention of 12 June 1961 between the United Kingdom and Norway providing for the reciprocal recognition and enforcement of judgments in civil matters). A judgment of a foreign court or tribunal of a state not party to the Lugano Convention can be directly enforceable in Norway subject to fulfilling certain requirements.

6.4 A Foreign Lender's Ability to Enforce Its Rights

Lending is a strictly regulated activity in Norway. Violations would, however, be met with penalties and an administrative order to cease and discontinue the illegal activity. As such, there are no limitations applicable to a foreign lender's ability to enforce its rights under a loan or a security agreement, and even if the loan was granted in breach of Norwegian financial activity rules, the loan agreement and appurtenant security agree-

ments would not on this basis alone be rendered void and unenforceable.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

The rights of a secured creditor must be respected in both individual and joint enforcement, however bankruptcy proceedings will generally limit the secured party's participation in the joint proceedings, as they will be led by a liquidator appointed by the court. An automatic stay of up to six months may apply before the security is enforced on an individual basis. Exceptions apply, however, including in respect of security granted under the Financial Collateral Act as described above.

7.2 Waterfall of Payments

The rules for payment of dividends to (unsecured) creditors in an insolvency are complex and follow from mandatory provisions of law. Generally, the waterfall can be described as follows:

- costs incurred as a result of the bankruptcy or by the bankruptcy estate during the insolvency proceedings;
- various salary claims incurred prior to opening of bankruptcy;
- taxes, VAT, etc; and
- various subordinated claims (and agreed subordinated claims).

Secured creditors are allowed to claim as unsecured creditors for the part of their initially secured claim which was not covered by enforcement of the security.

7.3 Length of Insolvency Process and Recoveries

This will vary depending on the complexity of the bankruptcy estate. As a general rule, all assets which are secured in favour of lenders will usually be released by the bankruptcy estate and made available to the secured creditors quickly after opening of bankruptcy.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

A company that has or will have in the foreseeable future, serious financial difficulties may file for reconstruction under the Reconstruction Act. The Reconstruction Act introduces a more flexible legal framework for continued business operations in close co-operation with the creditors.

Debt negotiations can be entered into by the debtor without involving the courts. Unless a secured creditor has expressly agreed not to enforce or take ownership of the collateral, the secured creditor is not affected by these negotiations. Court-administered debt negotiation proceedings can only be initiated by a willing debtor. This debtor must demonstrate that they are unable to meet their payment obligations as they fall due and that it is not unlikely that the debtor will obtain a composition with their creditors.

7.5 Risk Areas for Lenders

There is a clear distinction under Norwegian law between secured and unsecured creditors. A secured creditor would normally get access to its security asset from the bankruptcy estate manager quickly during the bankruptcy process. There is a good chance of recovery for a secured creditor if the value of the assets has upheld well, taking into account that there usually would be some costs incurred in connection with realising

the security asset. Unsecured creditors would be paid out after creditors which are mandatorily preferred by law, and the chances of recovery are usually very low. A typical payment to an unsecured creditor would normally be a small percentage of the face value of the claim. On this basis, typically unsecured creditors try to negotiate with a borrower in financial difficulty a solution whereby they can obtain security for their claim. As secured creditors have a much better standing in the bankruptcy, such transactions where new security is granted for old debt are susceptible to be set aside by the bankruptcy estate if they have been undertaken within a certain time frame before bankruptcy was opened.

8. Project Finance

8.1 Recent Project Finance Activity

Project financing in Norway has been used extensively in asset-based financings, such as within real estate or shipping and offshore. It has, to a certain extent, also been used for financing other types of projects with an agreed cashflow, such as renewable energy projects (particularly related to onshore wind projects) and to some extent public communication and infrastructure through public-private partnership transactions. During 2023, there has been an ongoing auction process for Norway's two first offshore wind areas (with more acreage expected to come up for auction in 2025). It is assumed that project financing will be an important part of developing offshore wind into a new source of renewable energy in Norway.

8.2 Public-Private Partnership Transactions

Public-private partnerships (PPP) have been used to some extent in Norway, although somewhat on and off, which is mostly due to different governments having diverging political opinions on the benefit of using private capital to deliver public services. For many years, PPPs have been used to finance various selected construction projects for new roads and bridges in particular. Although the trend is increasing, the pace has been somewhat slower than in other jurisdictions where this has been a more sought-after source of financing. In Norway, the object of a PPP has often been more to see if a private solution could reduce costs of construction as compared to a fully governmentally managed project, as opposed to providing access to financing. Under the current political landscape there is also a trend towards a decreased level of private services, for example in relation to healthcare and nursery homes. Although not strictly a PPP, there was a trend for some years whereby public authorities and municipalities sold public infrastructure and buildings to private investors, which either leased the assets back or sold the relevant service back to the vendor. Although now in reverse, the authors believe that this trend may come back at some point in time.

There are a variety of public regulations and requirements associated with governmental activity in Norway, so any significant transaction with any governmental authority or a company which is wholly owned by such needs to be carefully assessed. Any breach of, for example public procurement legislation, may be challenged by competing interests.

8.3 Governing Law

In relation to the new offshore wind projects, the Norwegian ministry responsible for granting offshore wind licences is considering imposing a condition that the licensed offshore wind activities must be governed by Norwegian law contracts. There is no direct suggestion that such

requirement would extend to the financing of the relevant project, but the authors cannot exclude the possibility that the government also takes into account the governing law of the proposed financings when granting licences (scheduled for early 2024).

8.4 Foreign Ownership

At the outset, there are no foreign ownership restrictions on real estate, provided that there are no implications with regard to sanctions, or the ownership is not related to certain regulated industries, which are regarded as critical to Norwegian natural resources (or strategic interests). This could, for example, relate to ownership of real property over land-based seafood, which requires a concession from the authorities. Please also note that there are ownership restriction rules applicable (both to Norwegian and non-Norwegian owners) in certain other industries related to resources of the ground or from the seabed, such as for hydropower plants. As a general rule, however, obtaining security would require a licence from the relevant authorities upfront. Whilst a security interest would not automatically be set aside, the relevant requirements would have to be taken into account when enforcing the relevant security.

8.5 Structuring Deals

A significant factor in structuring a project financing is determining the legal form of the project company, taking into consideration liability and tax effects, based on Norwegian company-related legislation. An SPV in a project financing, which will incur significant investments prior to becoming cash flow positive, will often be incorporated as an unlimited partnership (*Delt Ansvar* or "DA"). When an SPV with unlimited partnership generates taxable income, it will not be taxed at the SPV level, but rather flow up to each respective partner based on its ownership share. Each partner will in turn often be incorporated as a limited liability company and can take advantage of group contributions to offset tax income or losses in other parts of the Norwegian tax group. Through this structure and generally speaking, partners with taxable income in Norway can benefit from the tax losses in the SPV's early phase to offset such taxable income in other parts of the group. The parties would also need to consider each partner's recourse to other assets to mitigate the unlimited nature of the SPV's liability.

Also, for any project financings which involve the acquisition of a Norwegian limited liability company, please refer to **5.4 Restrictions on the Target** setting out the Norwegian financial assistance rules, which are quite strict. As outlined there, in order to be able to benefit from the relevant "whitewash" exceptions and thereby be allowed to obtain guarantees and transaction security from a Norwegian target company, the acquiring entity must be incorporated within the EEA.

8.6 Common Financing Sources and Typical Structures

Bank financing remains, in the authors' view, clearly the largest source of project financing in Norway for all construction projects. To some extent, export credit financing providers are also seen being included in these structures. For project financing within the real estate sector, bond financings have also been extensively used, particularly for projects which are out of the construction phase and more into the operations phase (and further development alongside normal operations). Particularly within the real estate sector, but also in some more aggressive corporate refinancings, a more extensive layering of debt sources, with up to three layers of

debt, has been seen. A typical example could be super senior bank, senior bond and junior bond.

8.7 Natural Resources

The most notable requirement in relation to natural resource project developments in Norway is that of public ownership, which entails a requirement for two-thirds public ownership in certain hydropower projects. Moreover, any change of ownership requires governmental approval in other contexts, such as in connection under the Norwegian Petroleum Act and the Marine Energy Act. There is no direct Norwegian ownership requirement on fish farming, but a resource rent tax has been imposed on sea-based fish farming (although not land-based fish farms). There are also resource rent taxes on upstream petroleum activities as well as hydropower plants. The resource rent is calculated on a spot price basis, which means that price protection contracts need to be adjusted to reflect the size of the tax in order to be effective. Finally, and on a general basis, all licence-based operations and businesses will need to comply with the conditions on which the licence is granted, including as regards duration and degree of utilisation.

8.8 Environmental, Health and Safety Laws

Under the Norwegian Transparency Act of 2021, companies are required to carry out due diligence (*aktsomhetsvurderinger*) on fundamental human rights and decent working conditions in line with the OECD Guidelines for Multinational Enterprises, and they must report on their efforts annually. Also, the labour market in Norway is strictly regulated and all project companies must adhere to detailed rules with regard to salaries, working conditions, as well as general HSE requirements. Major breaches of relevant HSE requirements can be considered a criminal offence under Norwegian law, whereas less serious offences would typically be settled by fines and/or injunctions to correct the relevant breaches.

Trends and Developments

Contributed by:
Ida Marie Windrup and Audun Nedrelid
Advokatfirmaet BAHR AS

Advokatfirmaet BAHR AS was established in 1966 and serves as adviser, problem solver and partner in strategic discussions for Norwegian clients in domestic or international matters, as well as foreign players facing opportunities or challenges in Norway. BAHR offers all business-related legal disciplines, with offices in Oslo and Bergen, and around 200 fee earners. The firm's banking and finance team combines industry understanding and tier-1 legal capabilities to enable value-maximising transactions for its clients. Recent deals include acting for seafood giant SalMar in relation to its unsecured debt facilities totalling NOK16 billion. BAHR also acted on behalf of the banks, in relation to financing of NOK4.2 billion for debt collection group Kredinor, in connection with Kredinor's cross-border merger with the Modhi group. As part of BAHR's cutting-edge approach, former long-term partner at Pareto Securities, Stian Winther joined BAHR's Banking and Finance team as strategic advisor, to strengthen the team's ability to deliver tailored and innovative legal advice to its clients.

Authors

Ida Marie Windrup is a partner at BAHR and heads up its debt capital markets group, which includes the banking and finance team. Ida advises leading Norwegian and international banking and investment clients on debt financing transactions, with a focus on secured asset, project and acquisition financing transactions. Ida works across a variety of sectors and industries, including infrastructure and technology, as well as ocean-related industries. She is dual qualified as a Norwegian advokat and an English solicitor.

Audun Nedrelid is a debt capital markets financing specialist, working both within the banking and bond markets. He regularly acts for issuers and borrowers, advising both major corporate clients and private equity clients on some of their most substantial transactions. Such transactions fall within both traditional bank lending and capital markets issues of bonds, as well as other private placement debt. His experience ranges from corporate loans for blue chip borrowers, asset-based financings (with a particular emphasis on shipping and offshore loans, as well as infrastructure financings) and leveraged/acquisition financings to combined bank and bond or direct lending structures with appurtenant intercreditor issues.

Contributed by: Ida Marie Windrup and Audun Nedrelid, **Advokatfirmaet BAHR AS**

Advokatfirmaet BAHR AS

Tjuvholmen allé 16
NO-0252 Oslo
Norway

Tel: +47 21 00 00 50
Email: post@bahr.no
Web: www.bahr.no

General Trends in Norwegian Debt Financing

Bank lending remains the main source of debt capital in the Norwegian market, although the introduction of more rigid capital adequacy rules in recent years has limited the growth in bank lending of Norwegian banks. As lending is a strictly regulated activity in Norway, any shortfall in corporate bank lending has traditionally been covered by tapping into Norway's very active high-yield bond market where, in particular, the internationally oriented and capital-intensive businesses such as shipping and offshore service suppliers have been able to raise substantial amounts of asset-backed debt capital. The high-yield bond market has, in addition to traditional corporate financing, to a certain extent also been used as a source for financing of acquisitions, and this is a trend that we expect to continue in the years to come.

Direct lending is also on the rise in the Norwegian debt capital market. Some of the largest debt financing transactions in the Norwegian market in recent years have been backed by substantial amounts provided by non-bank lenders such as debt funds and other capital managers like insurance companies. The regulatory requirements mentioned above do however put some limitations on the use of direct lending in Norway (see separate assessment of the use of direct lending market in Norway below).

Another notable trend in the Norwegian market is the energy shift into renewables, which has already seen significant amounts invested into renewable energy ventures. As Norway has traditionally had a large percentage of its economy in the energy sector, it is expected that this will hold true also after the "green shift" into renewable power and related products. However, Norway has not yet granted permits for offshore wind farms and is therefore somewhat behind the international trend in what will probably be an important contributor to renewable energy in the green shift to come. The first licences for offshore wind projects are currently scheduled to be granted early in 2024.

Acquisition financing is always an important driver of debt capital financing. This also holds true in Norway, and is probably something which we will see more extensively used in the Norwegian market as a result of eased Norwegian financial assistance rules which will give lenders a better security position in acquisition financings than what was previously the case. We have provided more detail on this trend in a separate section below.

Acquisition Financing in Norway

Norway has traditionally had strict financial assistance rules, with the consequence that a Norwegian company was only allowed to grant

guarantees or security, or advance funds in connection with an acquisition of the shares in a Norwegian entity or a parent company of a Norwegian entity, under very strict limitations. Historically, these limitations generally resulted in guarantees and security granted by a Norwegian target company and its subsidiaries extending only to cover the amount of debt already incurred by such Norwegian entities and refinanced as part of the acquisition. Parties would typically deal with the financial assistance prohibition by obtaining the usual security package consisting of guarantees and security documents from the Norwegian target company and its subsidiaries, but adding appropriate limitation language to ensure that the security and the guarantee obligations incurred would only extend to the amount allowed under the law from time to time. In this way, the robustness of the security package from the target group in question would be a question of fact under the relevant acquisition financing.

As a result of the above financial assistance restrictions, lenders have had to rely to a larger extent on negative pledge clauses and prohibitions against additional financial indebtedness in the Norwegian target group, to get a satisfactory level of comfort. It is therefore our impression that Norwegian acquisition financings have traditionally provided less flexibility for the borrower and its subsidiaries under Norwegian law.

In 2020, new legislation was finally introduced to ease the possibility for a Norwegian target company to grant security for acquisition financings, with further clarifications given by the ministry in early 2021 on how the new exemption was intended to work. As a result, it is now generally considered possible for the lenders under an acquisition financing to obtain guarantees and security from a Norwegian company that has been acquired (either directly or indirectly through a parent company) if the company acquiring the shares is incorporated in an EEA jurisdiction and will control the Norwegian target entities following the acquisition. In addition, a detailed documentation ("whitewash") procedure must be complied with.

The validity of the financial assistance (in the form of guarantees or security) granted by a Norwegian target group company is, however, still determined based on facts and not formality, as this goes to corporate benefit for the grantor of such financial assistance. The whitewash procedure is therefore not a mere formality that can be relied upon to ensure a "safe harbour" for these financial assistance rules, and the corporate benefit assessments required must be carefully assessed based on the matters of fact on each occasion and based on the arms' length principle.

Applied correctly, the new legislation and the clarification from the ministry should give better security for lenders and thereby improve the possibility for securing acquisition financings for Norwegian targeted takeovers going forward.

Direct Lending in Norway

Over the last couple of years we have seen a significant increase in direct lending in the Norwegian market. For a country with strict licensing requirements for lending activities, this is an interesting trend and, we expect, a growing one as regards the Nordic region.

Looking first at the regulatory landscape, providing financing services (including the provision of loans and guarantees) is a regulated activity in Norway. Prospective lenders to Norwegian companies must, as a starting point, be licensed or passported as either an EEA-based credit insti-

tution or as a European long-term investment fund (ELTIF).

There are some exceptions available, however, including where the facts at hand create a basis for "reverse solicitation". Reverse solicitation requires a detailed analysis, but generally speaking it would require the loans to be provided entirely from a lender located outside of Norway and on a Norwegian borrower's initiative, without the relevant lender having marketed or recommended the loan to the Norwegian borrower prior to the borrower's decision to initiate the transaction. The direct lending transactions which have been observed in the Norwegian market over the last few years have typically been made available to a borrower being a newly established bidco on a reverse solicitation basis, and where the initiative for granting the loan has been taken by a sponsor of the bidco. Typically, these sponsors have been private equity funds located in London or New York, which have approached the direct lending providers outside of Norway and completed the negotiations of the financing terms even prior to the Norwegian bidco having been formed.

Another available exception is where the loan is structured as debt securities, as the Norwegian regulatory restrictions on providing debt financing do not extend to purchasing debt securities. Issuance of bonds in the Norwegian market does not require an official credit rating for the issuer/borrower, and the issue will typically be documented on a bond format which is familiar to the investors. The most used formats are the documentation templates developed by Nordic Trustee AS. Issuances of bonds in the Norwegian market can be done both broadly to a range of potential investors, or private to only one or a few investors. If the bonds are sold to a defined group of investors, the bond issue will still be considered a private placement as the investors are all professional, and the transactions are almost always done under a relevant exception from the prospectus regulations. For more privately held bonds, issued to one or just a very limited number of bond investors, the terms are often heavily negotiated and bespoke with regard to the particular transaction in question. These more privately held bond issues would typically have been structured under a more commonly seen direct lending format if it had been possible from a regulatory perspective to do non-bank, direct lending in the Norwegian market.

We will address loans falling within both of the above main categories, being direct lending and bond issues, in turn.

Direct lending

In our discussions with key market participants in the direct lending space and which have been granting loans into Norway, we have observed the following regarding terms being negotiated in the direct lending space:

- as underlying interest rates have increased, an investor's absolute return is now obviously better for lower risk positions, hence the direct lenders demand – on a relative basis – higher risk premiums for taking on more risk than in a low interest rate environment;
- due to the macro-economic uncertainties which are still prevailing, investors have been more selective on type of exposure they seek; and
- with rather expensive pricing, borrowers sometimes favour slightly shorter tenors, implying an expectation of obtaining refinancing earlier and at better terms than what has typically been the case.

There is limited transparency regarding the terms and market share of the direct loans not documented as debt securities. These loans vary both in size, structure as well as purpose, but based on what we observe in the market, they will often be to finance an asset and, maybe even more so, for acquisition financing (both in relation to a private limited company or for the purpose of a take-private transaction).

Because these loans tend to be highly leveraged, they will generally be secured, and security may be held by the lender directly or by a third-party professional security agent or trustee service such as Wilmington Trust, Kroll or GLAS.

Private debt transactions structured as debt securities

Nordic Trustee AS has a lending portfolio of around 100 active private debt transactions, not including bilateral loans on bond format which are classified as bonds in Nordic Trustee's statistics. Typical loan sizes are in the range of EUR20–600 million, and lenders include leading international debt funds, PE sponsors and life insurance companies.

Outlook for the Coming Years

Norway has an open and internationally oriented economy, heavily weighted towards exports, and the outlook for the lending activity in the Norwegian market will therefore, to a large extent, depend on the trends in global trade and the international finance markets. The trend we have seen in recent years with capital markets lending (including direct lending) taking a larger share of the debt market in lieu of bank lending will probably continue in the years to come.

Whilst the Norwegian economy, taken as a whole, is primarily influenced by the developments in the oil and offshore sectors, high activity is also being seen in the major green shift into renewable energy sources. Other sectors are generally also becoming more important. In particular, we would expect to see increased activity in the intersection between the tech sector and Norway's more traditional industries – especially within industries contributing to the green shift. It will be interesting to see if the high ambitions for developing new, renewable energy in Norway can be realised within the expected time frame. To enable that, large amounts of capital – including debt capital – must be made available to developers over the next few years.

PANAMA

Law and Practice

Contributed by:
Patricia Cordero, Arturo Gerbaud and Rita de la Guardia
Alemán, Cordero, Galindo & Lee

Contents

Alemán, Cordero, Galindo & Lee (Alcogal) advises many of the world's largest and most sophisticated financial institutions on the full range of banking, securities and related regulatory matters in Panama. It is an acknowledged industry leader in the banking and finance sector and has been involved in some of Panama's largest and most complex financial transactions. Alcogal represents many of the local and global leading financial institutions in both international and domestic bank financing, as well as in other forms of acquisition and project financing, including public tender offers, asset purchase financing and mezzanine financing. The lawyers advise clients on their ongoing regulatory and disclosure obligations with all the relevant local and foreign authorities and ensure that they are up to date on all legislative developments. The firm also represents financial institutions and/or intermediaries in obtaining government-issued licences to operate in Panama, in accordance with all banking and securities laws.

Authors

Patricia Cordero is a partner at Alcogal, where she has been part of the corporate team since 2010. Her practice areas include banking, finance, M&A and general corporate matters. Patricia has been active in several of the most complex and relevant financing and structuring transactions handled by the firm, assisting clients such as the Bank of Nova Scotia, Citibank, Banistmo, Banco General, Global Bank, Grupo Ficohsa and Banco Azteca (Panama). She has also assisted Alcogal's banking clients in connection with several high-profile debt restructuring deals.

Arturo Gerbaud joined Alcogal as a partner in 1992 and is widely regarded as one of Panama's foremost banking and finance lawyers. His professional practice concentrates on banking, finance, capital markets, M&A and general corporate matters. Arturo's experience includes advising local and international financial institutions, such as Citibank, the Bank of Nova Scotia, Banco General, Global Bank, St George's Bank, BAC International Bank (Panama), Banistmo and Banco Itaú.

Rita de la Guardia is a partner at Alcogal and joined the firm in 2014. Her professional practice concentrates on banking, finance and capital markets, M&A and general corporate matters. Rita has been active in various project finance transactions as well as corporate finance, assisting clients such as BAC International Bank (Panama), the Bank of Nova Scotia, AES, Celsia, Global Bank and Banco General.

Alemán, Cordero, Galindo & Lee

2nd Floor
Humboldt Tower
Calle 53 Este
Marbella
Panama City
Republic of Panama

Tel: +507 269 2620
Fax: +507 263 5895
Email: marketing@alcogal.com
Web: www.alcogal.com

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Prior to the COVID-19 outbreak, Panama had been fortunate in mostly avoiding the recent economic down-cycles in Latin America and beyond. From 2001 through 2013, Panama's economy grew at an average of 7.2% per year. However, this rise dropped to 4.9% in 2016, before resurging to 5.5% in 2017 and 2018 and then dropping to 3% in 2019, ahead of an alarming COVID-19 downturn of -17.8% in 2020, followed by a 15.3% GDP growth rate in 2021, driven by copper mining, construction, manufacturing and commerce.

During the height of the pandemic, the banking regulator issued temporary relief measures, which have now concluded; beyond that, the regulatory environment has so far not been affected in terms of the direction and trends in the loan market in Panama. Like many other economies in the region, the current interest rates seem to have caused a slowdown in large financial transactions, but the market is now adjusting to the new rates and transactional activity is picking up.

1.2 Impact of the Ukraine War

The Ukraine war has not had a direct effect on the terms and trends of the loan market in Panama.

1.3 The High-Yield Market

The high-yield market is not an important source of finance in the emerging trends in Panama.

1.4 Alternative Credit Providers

The loan market in Panama has not seen significant growth in alternative credit providers; Panama's well-established banking centre continues to be the main source of credit for local credit transactions, by far. There has been a notable increase of private funds as alternative credit providers.

1.5 Banking and Finance Techniques

Banking and finance techniques are evolving every day, mainly in connection with tax efficiencies, to reflect the investor base and the needs of borrowers. In this respect, corporate financings are being structured by way of securities issuances, registered with the Superintendence of Capital Markets of Panama, and listed with the Latin American Stock Exchange (Latinex).

Instead of granting traditional loans, banks are financing their major corporate clients by underwriting securities issuances, thereby providing their clients with innovative tax efficiencies.

1.6 ESG/Sustainability-Linked Lending

There is an increasing trend of large Panamanian companies strengthening their ESG policies and practices, but sustainability-linked lending is not a common concept in Panama.

2. Authorisation

2.1 Providing Financing to a Company

Both banks and non-banks may provide financing to a company organised in Panama. Foreign financial institutions may also provide financing, from abroad, to a company organised and domiciled in Panama. Typically, entities that provide financing on a regular basis in or from Panama would be required to be regulated by:

- the Superintendence of Banks if they provide other banking services, especially deposit-taking activities;
- the Superintendence of Capital Markets if they provide other brokerage services or investment advice; or
- the Ministry of Commerce in the case of financial entities that provide small personal loans.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Foreign lenders are not restricted from granting cross-border loans to companies in Panama.

3.2 Restrictions on Foreign Lenders Receiving Security

The granting of security or guarantees to foreign lenders is not restricted or impeded.

3.3 Restrictions and Controls on Foreign Currency Exchange

Panama does not apply any restrictions or controls regarding foreign currency exchange and does not have a central bank. The US dollar has been legal tender in Panama since 1904 and it is pegged one-to-one with the Panamanian balboa.

3.4 Restrictions on the Borrower's Use of Proceeds

Panama does not apply any restrictions on the borrower's use of proceeds from loans or debt securities (assuming their use is for legal purposes). Regarding debt securities, the proceeds cannot be used to pay dividends to the shareholders of the issuer.

3.5 Agent and Trust Concepts

The agent concept is not explicitly regulated in Panamanian law but is something that is increasingly contractually regulated between lenders and borrowers in Panama, particularly for syndicated loans. Agency arrangements created under the laws of another jurisdiction are also recognised in Panama and are commonplace.

The trust concept has been legally recognised in Panama since 1984. Please note that a Panamanian trust is not a separate legal person, but rather a legal arrangement via which the settlor transfers assets to a trustee to be managed or disposed of as described in the trust deed, in favour of the beneficiaries of the trust. This arrangement separates the trust's assets from the assets of the settlor, shielding them from lawsuits and other proceedings brought against

the settlor, but does not create a new legal person. The guaranteed trust is an oft-used collateral instrument in local credit transactions. Alternatively, local borrowers are often required to provide guarantees (personal and corporate), mortgages (real or chattel), assignments (eg, accounts payable) and pledges (over shares, bank accounts, assets, etc).

3.6 Loan Transfer Mechanisms

Most local loan agreements (and related security documents) typically have standard assignment clauses, allowing the lender to assign either the agreement as a whole, or the credits that result from the agreement. In the absence of such contractual language, Panama law requires consent from the borrower to implement a transfer of the agreement, and requires notice for the transfer of any credit arising from the agreement.

3.7 Debt Buy-Back

Debt buy-back by the borrower or sponsor is permitted; however, under Panama law, in the event of such a buy-back by the borrower, the debt would be considered extinguished.

3.8 Public Acquisition Finance

There are no provisions with respect to public acquisition finance transactions in Panama.

3.9 Recent Legal and Commercial Developments

There have been no recent legal or commercial developments that have required changes to Panama's legal documentation, other than the changes seen worldwide in connection with the migration from LIBOR to SOFR and the inclusion of language for alternate reference rates in relation to changes to SOFR. However, it is now commonplace for anti-money laundering clauses and anti-financing of terrorism clauses to be boilerplate language in commercial loans.

3.10 Usury Laws

In the case of commercial loans, there are no usury laws or other rules limiting the amount of interest that can be charged.

3.11 Disclosure Requirements

There are no rules and/or laws regarding the disclosure of certain financial contracts.

4. Tax

4.1 Withholding Tax

The payment of interest, commissions and other charges to local lenders will not be subject to withholding tax but may be subject to income tax and other taxes, and should be included in the lenders' tax returns.

The payment of interest, commissions and other charges to foreign lenders will generally be subject to withholding tax, at a rate of 12.5%. However, this will not be the case if:

- the proceeds of a loan will not be used economically in Panama;
- the proceeds of a loan will not be used for the production of income of Panamanian source, as defined in Article 694 of the Fiscal Code of Panama; and
- any payments on interests, commissions and other charges will not be considered by any person as a deductible expense for Panamanian income tax purposes.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Credit facilities granted to companies that generate Panama source income are subject to a stamp tax in the Republic of Panama at a rate of USD0.10 for each USD100 of the value of any such document. Further, stamp tax is also pay-

able in the event that an agreement is presented before a Panamanian tribunal or administrative entity.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Foreign lenders making loans to entities incorporated and domiciled in Panama should be aware that the credit agreement will be subject to stamp tax in the Republic of Panama at a rate of USD0.10 for each USD100 of the value of any such document, if presented before an administrative authority or court in the Republic of Panama as evidence.

5. Guarantees and Security

5.1 Assets and Forms of Security

In Panama, it is not possible to use a "security interest" as a generic and general guarantee. Panamanian law recognises personal guarantees and real guarantees. The most common real guarantees (in rem) are pledges, mortgages and antichreses.

Pledges and Mortgages

A pledge is a type of real guarantee, which may be given over all kinds of movable assets. A pledge must be constituted with the same formalities as the agreement setting out the obligations it guarantees. However, it is essential that the pledged asset is delivered to the creditor or a third party as a depository for its protection. As such, Panama law does not permit non-possessory pledges.

Intangibles such as credits and rights are considered movable assets under Panamanian law and can be the subject of a pledge if they are individually identifiable. Credits represented by negotiable instruments must be endorsed in pledge and delivered; this also applies to shares in companies. In general terms, the available structures for encumbering the shares of a Panamanian company would be to constitute either a pledge (under Panama law or the law of another jurisdiction) or a mortgage over the shares. If the shares are dematerialised and deposited in an investment account, the investment account could be pledged.

The convenience of a pledge over a mortgage

Pledge agreements are usually executed in a private document and do not have to be registered, thus making them more time and cost-efficient. Mortgage agreements must be granted in a public deed and registered in the Public Registry of Panama. Furthermore, the mortgage structure and process also require that:

- a summary of the principal obligation (ie, the obligation guaranteed by the mortgage) is included in the public deed that contains the mortgage;
- the signatories of the mortgage must be physically located in Panama, as they must appear before the notary public;
- the mortgage and its related documents (eg, powers of attorney or corporate authorisations) must be issued in Spanish or immediately translated by an authorised Panamanian public translator; any documents executed abroad must also be duly apostilled at the beginning, to be incorporated into the public deed;
- the mortgage must be registered in the Public Registry of Panama, which entails paying registration fees based on the secured amount under the mortgage agreement, at a rate of USD42 for the first USD20,000 and USD30 for each additional USD10,000 or fraction thereof; furthermore, the public deed contain-

ing the mortgage agreement is subject to stamp tax at a rate of USD8 per page;
- registrations in the Public Registry of Panama are of public record which, in practical terms, means that the information pertaining to the principal obligation, as well as that of each holder of a mortgaged share, is publicly known (publishing the information of a company's shareholders is not standard local practice, given that corporations in Panama are anonymous (*sociedades anónimas*) and the identities of their shareholders are not a matter of public record); and
- any changes or amendments to the mortgage agreement must also be granted in public deed and registered in the Public Registry.

For a pledge agreement to be perfected, the pledge assets (the shares of the Panamanian company) must remain outside the control of the pledgor (the custodian can be any agreed-upon third party including, but not limited to, the lender) while, under a mortgage structure, the mortgaged assets usually remain under the control of the mortgagor.

Judicial or extrajudicial execution of a pledge

Under a pledge agreement, the parties can agree to execute the pledge either judicially or extrajudicially. If a special method of execution is not agreed by the parties in the pledge agreement, Articles 820 and 821 of the Commercial Code of Panama provide a simple extrajudicial method for execution of the pledge, under which the pledgee must grant the pledgor 30 days' notice for the sale or transfer of the pledge assets, the value of which will be determined by two expert witnesses named by the parties, or if there is a disagreement, by a third expert witness named by the first two expert witnesses or by a judicial authority. However, it is common for the parties to agree upon an extrajudicial method of execution in the pledge agreement itself.

Judicial or extrajudicial execution of a mortgage

A mortgage will be judicially executed unless otherwise agreed by the parties (Article 43 of Law No 129 of 2013). However, even if the parties agree on an extrajudicial sale, the following proceedings must occur.

- The parties must name a representative or entity to carry out the required notifications (Article 46 of Law No 129 of 2013).
- The mortgagee must present an execution form to the Public Registry of Panama; thereafter, the mortgagee shall ask the representative to notify the borrower and the mortgagor. Furthermore, the mortgagee must notify any other registered mortgagees, if applicable, of the execution (Article 47 of Law No 129 of 2013).
- Once notified, the borrower and the mortgagor may choose to deliver the mortgaged assets or oppose the execution. If the execution is opposed, the opposing party must file their opposition with a judge (sole instance) no later than eight days after being notified of the execution. Thereafter, the mortgagee has three days to answer the opposition. If the opposing party presents evidence, the judge will order the practice of that evidence. If the judge determines that the sale shall continue, they will order the apprehension of the mortgaged assets and their corresponding sale; if the judge determines that the sale shall not take place, the sale will be terminated, and the judge will instruct the Public Registry to annotate in its records that the execution has been terminated (Articles 50 and 51 of Law No 129 of 2013).

Similarities between pledges and mortgages

Notwithstanding the above, there are some aspects of the pledge and the mortgage that are very similar and do not pose a particular advantage or disadvantage when comparing one form of security with the other.

Under Panamanian insolvency, reorganisation and liquidation law, a duly executed pledge or mortgage will constitute a valid and legal obligation of the pledgee or mortgagee, enforceable against it, and the corresponding pledgor or mortgagor will enjoy a first-priority security interest over the pledged or mortgaged assets, which will not enter the bankruptcy proceedings unless the pledgor or mortgagor waives their preferential rights. However, it should be noted that, under Law No 12 of 18 May 2016, which came into full force and effect on 1 January 2017, if the pledgor or mortgagor is subject to a Panamanian reorganisation order, all its assets, including the pledged or mortgaged assets, will be subject to a six-month financial protection period, during which the corresponding pledge or mortgage cannot be executed unless the lender files a reasoned argument to the corresponding judge demonstrating that the execution of the corresponding pledge or mortgage would not affect either the operations of the pledgor or mortgagor or the pledgor's or mortgagor's possibility of completing its reorganisation. Once the judge approves the execution of the corresponding pledge or mortgage during the six-month financial protection period or after the six-month financial protection period has elapsed, the lender can execute the corresponding pledge or mortgage as agreed therein. Throughout the reorganisation or the liquidation proceedings, as applicable, the lender will continue to enjoy a first-priority security interest in the pledged or mortgaged asset.

The pledge agreement or mortgage agreement, as a standalone structure, does not have any material tax considerations that need to be considered. The pledge agreement would be subject in Panama to stamp tax at a rate of USD0.10 for each USD100 of the value of the document if presented before a court or administrative authority in Panama as evidence. As the public deed containing the mortgage agreement would probably have incurred a registration fee higher than the resulting sum of the above-mentioned stamp tax, the stamp tax is waived for the purposes of the mortgage agreement.

Since the shares of a Panamanian company are a private matter not subject to public record, in order to verify whether these are already pledged or mortgaged, the lender would have to request that the pledgor or mortgagor provide them with a copy of the corresponding share registry.

The pledge agreement must be notarised; the mortgage is granted in a public deed and thus the notarisation process is implicit.

Certain rights in contracts may be assigned but are subject to what the respective agreement may dictate on the matter. However, the general rule is that the acceptance of the other party is required, as is the case for most insurance policies, in which it is necessary to have the consent of the insurer for the assignment of rights over such policies.

The enforcement of a pledge requires legal action before a competent court. However, it is possible to include in the agreement the possibility of the lender appropriating the pledged assets. In such cases, it is a matter of public policy to include in the respective pledge agreement a method to determine the fair value of the pledged assets. Otherwise, it is mandatory

to follow the procedure established in the Code of Commerce, which calls for a valuation of the pledged asset by two experts, one appointed by each party. If the two experts cannot agree, they must appoint a third expert for a final determination.

Bank accounts can be pledged, but this may present certain inconveniences when the account is used for cash flow of the business revenues, especially when dealing with banks that are very conservative. The pledging of accounts located outside Panama is subject to the laws of the country in which each account is held.

Trusts

Since the structure of operations of this type plays a complex role in the structuring of guarantees, such guarantees are increasingly being executed through trusts. A trust is an independent and autonomous contractual arrangement, as opposed to a pledge or mortgage, which is an accessory agreement that depends on the principal agreement. Through the use of trust agreements, bank accounts can be managed by the trustee, and rights over real estate property and other rights over movable property can be held in trust. Since ownership rights over the trust assets are transferred to the trustee, the intervention of judicial authorities for enforcement of said rights is not necessary.

In addition, certain types of assets can also be assigned as collateral through standard assignment agreements, either to the lender, a security agent or a trust structure.

5.2 Floating Charges and/or Similar Security Interests

The law in Panama does not permit a floating charge or other universal or similar security interest over all present and future assets of a company.

5.3 Downstream, Upstream and Cross-Stream Guarantees

It is possible for entities in Panama to give downstream, upstream and cross-stream guarantees.

5.4 Restrictions on the Target

No restrictions are imposed on a target granting guarantees, security or financial assistance for the acquisition of its own shares.

5.5 Other Restrictions

No restrictions are imposed on a target granting guarantees, security or financial assistance for the acquisition of its own shares.

5.6 Release of Typical Forms of Security

Depending on the type, security is most often released by mutual consent (in the case of a trust), registering a cancellation (in the case of a real property mortgage), and/or by the execution of a release document and return of pledged instruments (in the case of most pledge agreements).

5.7 Rules Governing the Priority of Competing Security Interests

The priority of competing security interests varies depending on the type and nature of the security. For example, Panama law allows for several ranking mortgages in the case of real and personal (movable) property, depending on the date of creation of such specific security and its recordation in the Public Registry. It also allows for mortgagees to vary their positions regarding their rank on a particular security. Contractual subordination is also fairly common and, in the absence of fraud on the part of an insolvent party, such provisions should survive the insolvency of a borrower incorporated in Panama.

5.8 Priming Liens

There are no priming liens in Panama.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Typically, a secured lender can enforce its collateral upon the occurrence of an event of default under the terms of the respective credit documentation. The traditional types of security and their enforcement mechanisms are outlined in **5.1 Guarantees and Security**.

6.2 Foreign Law and Jurisdiction

Under the laws of the Republic of Panama, the choice of a foreign law as set forth in the transaction documents is a valid choice of law, and the irrevocable submission of a Panamanian counterparty to a foreign jurisdiction, as set forth in those transaction documents, is legal, valid, binding and effective. A waiver of immunity would be upheld in Panama.

6.3 Foreign Court Judgments

Final Judgments

Subject to the issuance of a writ of exequatur by the Supreme Court of Panama, any final judgment obtained against a party in a foreign court relating to a transaction document would be recognised, conclusive and enforceable in the courts of Panama without reconsideration of the merits of the case, provided that:

- the foreign court grants reciprocity to the enforcement of judgments of Panamanian courts;
- the party against whom the judgment was rendered, or its agent, was personally (not by mail) served in this action within that foreign jurisdiction;
- the judgment arises out of a personal action against the defendant;
- the obligation in respect of which the judgment was rendered is lawful in Panama and does not contradict the public policy of Panama;
- the judgment is properly authenticated by diplomatic or consular officers of Panama or pursuant to the 1961 Hague Convention Abolishing the Requirement of Legalisation of Foreign Public Documents; and
- a copy of the final judgment is translated into Spanish by a licensed translator in Panama.

Arbitral Awards

In the case of an arbitral award, any foreign final award rendered against a party by an arbitration panel or arbitrator duly appointed and empowered in accordance with the terms of any of the transaction documents to which that party is a party, rendered in connection with an international arbitration, would be recognised and enforced against each party by the competent courts of Panama without re-examination of the merits, pursuant to the 1958 New York Convention on the Recognition of and Enforcement of Foreign Arbitral Awards or the Panama Inter American Convention on International Commercial Arbitration of 30 January 1975, as applicable, or, if both conventions are equally applicable, in accordance with the provisions of the convention that is more favourable to the party seeking recognition or enforcement of the foreign final award. For the purposes of this decision, an arbitration is deemed international if:

- at the time of execution of the arbitration agreement or of the agreement that includes the arbitration clause (the "Arbitration Agreement"), the parties thereto are established in different states;

- the seat of the arbitration panel, if determined in or pursuant to the Arbitration Agreement, or the place of performance of a substantial part of the obligations that are the subject matter of the arbitration dispute, is located or is to be performed outside the state where any of the parties to the arbitration proceeding has its establishment;
- the parties to the Arbitration Agreement have expressly agreed that the matter subject to the arbitration proceedings is related to more than one state; or
- the subject matter of the arbitration proceedings relates to the provision of services or the sale or disposition of assets or resources on a cross-border basis.

6.4 A Foreign Lender's Ability to Enforce Its Rights

There are no other matters that might specifically impact a foreign lender's ability to enforce its rights under a loan or security agreement, but a case-by-case analysis of the relevant transaction will be required to make this determination, particularly in the case of borrowers and/or collateral related to public concession agreements, or those that require any sort of regulatory or government approval.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

There are two types of insolvency proceedings contemplated under Law No 12 of 19 May 2016 (the "Law on Insolvency Proceedings"), namely liquidation and reorganisation.

Liquidation

Under a liquidation proceeding, the creditors' right to engage individually in enforcement actions is suspended. However, creditors with a pledge, mortgage or other real security right may continue enforcement actions individually or may opt to do so within the liquidation proceeding.

Reorganisation

Under a reorganisation proceeding, an "insolvency financial protection" (*protección financiera concursal*) shall apply from the time the reorganisation proceeding is declared open until the time when an agreement of reorganisation, agreed to by the General Assembly of Creditors, is confirmed by the corresponding bankruptcy judge. This also has the effect of suspending (staying) enforcement actions.

However, the creditors' right to enforce pledges or mortgages will be considered automatically re-established if:

- the agreement of reorganisation is not approved by the General Assembly of Creditors;
- the agreement of reorganisation is not confirmed by the judge;
- the agreement of reorganisation is breached; or
- six months pass from the time the insolvency financial protection started.

7.2 Waterfall of Payments

The general rules of preference and their order of payment are established in the Civil Code.

Movables (Personal Property)

The following credits have preference within certain movable assets:

- credits for work, reparation, conservation or sales price, regarding movables possessed by the debtor;

- credits secured by a pledge, regarding movables possessed by the creditor;
- credits secured by surety (*fianza*) relating to commercial effects or securities, granted in a public or commercial establishment;
- credits relating to transport, regarding movables transported, for the price, expenses and rights of transport and conservation up to the time of delivery and up to 30 days afterwards;
- credits relating to lodging, regarding movables of the debtor at the place of lodging;
- credits relating to seeds and cultivation expenses, regarding the related goods that are being harvested; and
- credits relating to leases of one year, regarding movables of the debtor on the leased property.

For two or more credits within this category, the following rules apply:

- credits secured by pledge exclude others up to the value of the pledged asset;
- regarding surety, if duly granted to more than one creditor, preference shall be determined by the date when the guaranteed obligation was assumed; and
- credits relating to seeds and cultivation expenses shall be preferred over those relating to leases.

Immovables (Real Property)

The following credits have preference within certain immovable (real) assets:

- the State's credits, on the real estate assets of the taxpayers, for the taxes that weigh on them;
- the insurer's credits on the insured real estate for two years of premiums and, if it were mutual insurance, for the last two dividends that have been distributed;
- mortgage and antichretic credits over mortgaged real estate registered in the Public Registry; and
- credits preventatively annotated in the Property Section of the Public Registry, due to judicial orders, including embargoes, seizure of assets or execution of judgments over the annotated real estate property, and only in connection with subsequent credits.

For two or more credits within this category, the following rules apply:

- the first two types of credits indicated above shall have preference over the latter two types; and
- preference for mortgage credits and credits annotated in the Property Section of the Public Registry (regarding immovables annotated by judicial order, seizure of assets or execution of judicial decisions) shall be determined by date of filing and annotation in the Public Registry.

Other

The following other credits have preference:

- tax credits of municipalities, as well as credits related to judicial expenses or administration of insolvency, duly authorised or approved;
- credits regarding a debtor's funeral; and
- credits regarding:
  (a) a debtor's last illness expenses;
  (b) stipends or salaries of a debtor's dependants or house employees, corresponding to the last year;
  (c) advance payments made by the debtor, for themselves or their family, for food and clothing during the last year; and
  (d) alimony.

For two or more credits within this category, the following preferences apply:

- the order in which these credits are listed in its own records; and
- if they are listed at the same level, in date order.

7.3 Length of Insolvency Process and Recoveries

The duration of insolvency proceedings in the Republic of Panama depends on an array of factors, such as the complexity of the case, including the number and classes of creditors and the diversity of non-liquidated assets. Note, however, that generally, the duration of an insolvency proceeding could take from one to two years, without including appeals or other submissions by creditors. As to the success of recovery, specific circumstances of the insolvent company could determine whether creditors can recover. For instance, whether the insolvent company has any assets, whether the creditors have a secured interest, and/or whether they have priority.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

There are no rules specifically establishing an out-of-court process for rescue or reorganisation in the Republic of Panama, nor any voting requirements associated therewith.

Debt restructuring efforts between a debtor and its creditors will mostly be governed by general rules of contract and obligations, and the agreement of other creditors may not be imposed on an individual creditor without consent.

In situations where a debtor has several creditors willing to negotiate with the debtor as a group, however, the creditors will usually enter into a standstill agreement, whereby they agree not to enforce any rights of execution against the debtor during negotiations.

The negotiations will be aimed at reaching an agreement between the creditors themselves, and between the group of creditors and the debtor, to balance the operational needs of the debtor with the obligations owed to creditors.

If negotiations are successful, these will most likely involve amendments to the individual contracts between the debtor and the creditors involved.

It is important to note that any creditors who are not part of negotiations, or who decide not to enter into an agreement with the other creditors or the debtor, will not be affected in any of their rights or privileges as creditors. Furthermore, any liens or encumbrances over the assets of the debtor will remain unaffected.

It is also important to keep in mind during negotiations that certain claw-back provisions established in the Law on Insolvency Proceedings may retroactively affect the validity of acts or contracts if insolvency proceedings are later commenced, with the following timeframes.

- Up to one year before:
  - (a) acts or contracts for which no consideration has been received, or which may be considered gratuitous even where consideration has been received;
  - (b) pledges, mortgages or other acts that may establish a preference over other credits;
  - (c) payment of debts that are not due; and
  - (d) amendments to the articles of incorporation that affect the capital of the company.
- Up to four years before:
  - (e) acts or contracts for which no consid-

eration has been received, in favour of partners, shareholders, administrators, directors, officers, liquidators and general attorneys-in-fact.

- No time limit:
  (a) acts where there has been simulation of facts, or fraud; or
  (b) transfers made with the purpose of avoiding creditors.

7.5 Risk Areas for Lenders

If the borrower becomes insolvent and the security provider or guarantor becomes insolvent, the guaranteed obligations will be at risk of non-payment.

This may not be a concern where the amount owed is secured with a pledge, a mortgage or other type of real right security, and the value of the collateral is sufficient to secure full payment. However, to the extent that the collateral is not sufficient to satisfy payment in full, the lender will still be at risk of non or partial payment, although presumably the risk will be lower.

Furthermore, if insolvency proceedings are commenced and the lender has no credits secured with a pledge, a mortgage or other type of real security, the enforcement rights of the lender would be suspended, and the lender's credit would be included in the mass of credits within the corresponding insolvency proceeding that would result.

It is also important to consider the risk of retroactively invalidating certain acts, contracts and transfers that may favour the lender, to the extent that these may be deemed to fall under a claw-back provision of the Law on Insolvency Proceedings.

8. Project Finance

8.1 Recent Project Finance Activity

Project finance activity is particularly active in the energy sector in Panama and in large governmental infrastructure projects. It is worth noting that in 2019, Panama enacted Law No 93 of 2019 (the "APP Law"), which establishes the legal framework for public private partnerships (PPPs) in the country (see **8.2 Public-Private Partnership Transactions** for further detail). The APP Law is an important step in the efforts to attract private investments in infrastructure projects in Panama.

8.2 Public-Private Partnership Transactions

PPPs are increasingly gaining traction in Panama and no specific legislation applies to them. However, certain Panamanian companies in the distribution and energy sector are of mixed ownership between the government and private entities, resulting primarily from the privatisation of public utility companies in the 1990s. In 2019, Panama enacted Law No 93, regulated by Executive Decree No 840 in December 2020, through which PPPs are regulated. Executive Decree No 840 authorises the use of PPPs for the development of transportation, logistics, energy, communications, irrigation, urban infrastructure, public buildings, social housing, infrastructure for recreational services, garbage collection and/or treatment, agricultural development, and the administration and management of state-owned assets.

Government institutions such as IDAAN (Water Authority), the Panama Canal Authority, the Social Security Office (*Caja del Seguro Social*), the National Bank of Panama (*Banco Nacional de Panamá*), the Panama Savings Bank (*Caja de Ahorros*), the Superintendency of Capital

Markets and the Superintendency of Banks are expressly excluded, as are public security services, medical health, public education and the extraction of metallic minerals. Nevertheless, Executive Decree No 840 states that the provision of infrastructure and equipment, as well as the replacement, upkeep and maintenance in such areas, may be subject to PPPs.

PPPs may be self-financed or co-financed. Despite the regulation being two years old, as far as is known no PPP project under the specific regulation is currently in the execution phase in Panama.

8.3 Governing Law

In general, there are no requirements for project documents to be governed by local law and disputes resolved in local courts or the courts of another specific jurisdiction, unless it is contractually mandated as part of the tender process.

8.4 Foreign Ownership

There are few restrictions on the ability of foreign entities (companies) owning property in Panama. However, there is a constitutional restriction that foreign entities (or entities whose capital is foreign) cannot own land established within 10 km from the respective borders. Further, there are constitutional restrictions on foreign governments owning land directly in Panama.

8.5 Structuring Deals

Generally, there are no restrictions on foreign investment in Panama, except for certain activities in which foreign governments (or government-owned entities) may be limited. There may also be relevant tax treaties that provide for a more favourable tax treatment. Typically, the project companies are corporations (*sociedades anónimas*), except for situations in which a shareholder of the project company is a US person, in which case, for US tax considerations, the project companies are typically structured as limited liability companies (*sociedades de responsabilidad limitada*).

8.6 Common Financing Sources and Typical Structures

The typical financing sources are banks and multilateral institutions, although various transactions have also been financed through export credit agencies. Project bonds are typically used in a take-out or refinancing of a project, and not at a green-field stage.

8.7 Natural Resources

There are no issues or considerations associated with the acquisition and export of natural resources in Panama.

8.8 Environmental, Health and Safety Laws

The principal rules and regulations are set out in Law No 41 of 1998 (General Environmental Law) and Executive Decree No 123 of 14 August 2009, which regulates that Law. Compliance and regulation of the sector are within the purview of the Ministry of the Environment, including oil and gas, power and mining activities, in so far as they are environmentally sensitive activities.

The Criminal Code of Panama also plays a role in these activities regarding the sections that pertain to environmental crimes, and where compliance with these sections is within the purview of the relevant public attorneys and judges.

In addition, the Sanitation Code and the Labour Code include rules regarding the applicable health and safety norms, with the Ministry of Health and the Ministry of Labour being the respective government authorities in charge of compliance with these rules.

PORTUGAL

Law and Practice

Contributed by:
Manuel Requicha Ferreira and Diana Avillez Caldeira
Cuatrecasas

Contents

Cuatrecasas is an international law firm with a strong presence in Spain, Portugal and Latin America, where it has offices in Chile, Colombia, Mexico and Peru. With a diverse multidisciplinary team of more than 1,800 professionals of 29 nationalities, the firm covers all areas of law with a special focus on business, applying knowledge and experience from a sectoral perspective focused on each type of business. The firm has 27 offices in 13 countries and works very closely with law firms in several other jurisdictions to provide teams that are tailored to the needs of each client and situation. It serves companies across all commercial and industrial sectors, as well as financial institutions, funds, supervisory authorities and government entities. In Portugal, Cuatrecasas has offices in Lisbon and Porto, with a total of 220 lawyers advising on all areas of business law. Cuatrecasas is committed to the principles of the UN Global Compact and the Sustainable Development Goals of the 2023 Agenda and has recently acheived gold status in its EcoVadis assessment.

Authors

Manuel Requicha Ferreira is the co-head of the banking, finance and capital markets practice of Cuatrecasas in Portugal. In recent years, he has advised on a wide range of projects, including banking law and regulatory issues, structured finance, corporate finance and financing operations, including simple or structured debt issuances by public or private entities or public entities, as well as public distributions and takeovers. He has advised on many high-impact deals.

Diana Avillez Caldeira is a senior associate in the banking, finance and capital markets practice of Cuatrecasas. She has extensive experience advising corporations and financial entities on banking operations, debt restructurings, special situations and on the acquisition of distressed debt and non-performing loans (NPLs). She has advised on several high-profile deals in energy, infrastructure and project finance.

Cuatrecasas

Av. Fontes Pereira de Melo, 6.
1050-121 Lisbon
Portugal

Tel: +35 121 355 3800
Email: cuatrecasasportugal@cuatrecasas.com
Web: www.cuatrecassa.com

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

The instability caused by the war in Ukraine, the inflationary pressures and the increase in interest rates are having and will certainly continue to have an impact in the loan market in Europe and in Portugal, with an increase in financing costs and harder conditions for refinancing transactions.

Amid the current economic situation and outlook, Portuguese banks are restricting the granting of credit to companies and the respective credit conditions, on the grounds of risk perception. On the companies' side, the surveys of the Bank of Portugal indicate that demand for bank loans is decreasing. However, according to the data provided by the Bank of Portugal, the indebtedness levels (including loans, debt securities and trade credits) of the non-financial sector (that is, public entities, companies and individuals) increased in 2022. There was also an increase in the first half of 2023, although it was mainly driven by the public sector.

In recent years, we have seen an increase of direct lending because of the more stringent conditions imposed on banks to provide financing, in particular for development or acquisition loans.

1.2 Impact of the Ukraine War

The war in Ukraine has had significant effects, in particular the increase in the prices of raw materials, energy and food with the inflationary pressures that led to the increase of interest rates by the ECB. Additionally, the economic uncertainty caused by the war, in particular on GDP growth of EU countries, has also led to more stringent conditions and higher costs of financing (please refer to **1.1. The Regulatory Environment and Economic Background**).

However, the peak of energy prices caused by the war has accelerated the deployment of renewables to decrease dependence on Russian fossil fuels. In fact, we are witnessing an intensification of the pre-war trend of investment and consequently financing in renewables in the Portuguese market.

1.3 The High-Yield Market

In 2022, there was a decrease of more than 60% in European high-yield issuances when compared to 2021, which was a record year. However, 2023 is showing some improvement on the high-yield market which is becoming more attractive for investors with higher interest rates.

In Portugal, the statistics of the Bank of Portugal indicate that the issuance of debt securities has been substantially volatile during 2022 with a substantial decrease in bond transactions. There seems to be a recovery in the first half of 2023 with the new interest rate environment.

Regarding the financing terms, the use of floating interest rates is rising in the high-yield market, making bonds more attractive for investors in a scenario of rising interest rates.

1.4 Alternative Credit Providers

Alternative credit providers have not seen significant growth because credit activity is a regulated activity in Portugal. This substantially limits the activity of alternative credit providers, such as funds, which can only grant loans in specific situations (eg, loans granted by a certain type of investment fund (ie, venture capital funds) to SMEs).

Since 2019, loan funds have been recognised in the Portuguese jurisdiction. Loan funds are considered AIFs and are exempt from the banking monopoly rules, thereby allowing them to perform direct lending. They can grant loans (loan origination) as well as participate in loans acquired from the credit's originator or from third parties (loan participation).

Nevertheless, there has also been an increase in direct lending through the use of alternative funding schemes, such as the issuance of bonds.

1.5 Banking and Finance Techniques

The limitations detailed in **2. Authorisation** strongly limit the evolution of banking and finance techniques.

A good alternative method to raise financing is by way of the issuance and subscription of bonds integrated in a Portuguese clearing system, given that this activity is not qualified as a credit activity. This structure also presents certain tax advantages.

There has been some development and growth of financing through crowdfunding, new digital platforms and loan funds with new specific legislation.

In 2022, participative loans were introduced in Portugal by Decree Law No 11/2022. These are financing arrangements in the form of loans or debt securities, and the respective remuneration can be indexed, exclusively or partially, to a share in the borrower's profits and, in certain cases, may be converted into shares. Notwithstanding its innovative nature, the entities that can grant participative loans (even if in the form of debt securities) are essentially those that are already qualified to grant credit, so the new regime has limited impact on the diversification of financing.

1.6 ESG/Sustainability-Linked Lending

In recent years, the ESG and sustainability-linked lending market has grown significantly and has become one of the most active markets. There were a number of ESG-linked loans and green bond issuances by different market players such as utilities, power grid operators, telecom operators and food retailers.

Legislatively, trends have been mainly driven by the European Commission with the approval of Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment (the "Taxonomy Regulation") as well as implementing and delegated acts.

As part of the national legislation, Portugal approved the Climate Basic Law (Law No 98/2021), which includes several provisions that relate to sustainable lending.

2. Authorisation

2.1 Providing Financing to a Company

The granting of loans or other financing, which includes factoring, financial leasing and granting of guarantees, on a professional basis, is a regulated activity. Non-banks are, in principle, not authorised to provide financing to a company incorporated in Portugal, unless they incorporate one of the relevant credit institutions or financial companies authorised by the regulator to do so.

EU-domiciled banks may benefit from the EU passport established in the CRD IV and may be registered with the Bank of Portugal in order to carry out credit activities, allowing them to provide services on a cross-border basis without establishing any local presence in Portugal. This registration process is initiated by a notification made in the bank's home country indicating the activities that the entity wants to carry out in Portugal, which is then sent by the entity to the Bank of Portugal for registration. Upon receiving such a notification, the credit institution or financial company may begin to provide its services in Portugal under the EU passport.

However, non-EU-domiciled entities are only allowed to carry out banking activities in Portugal by setting up a branch or establishing a subsidiary, which both require specific authorisation procedures with the Bank of Portugal.

The Portuguese legislator has expressly established the reverse solicitation principle or passive marketing rule, in the case of the provision of services by a non-EU-domiciled entity on the sole initiative of the client. According to the reverse solicitation principle or passive marketing rule, if a Portuguese domiciled client directly contacts the non-EU-domiciled entity and requests a specified banking service on its own and exclusive initiative without any prior solicitation and marketing of such service by the entity, the aforementioned registration/authorisation with the Bank of Portugal will not be required.

If the credit operation is an isolated transaction, and there will be no further transactions in the future, it should not qualify as a professional credit activity according to the definition.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Please consider the restrictions mentioned in **2.1. Providing Financing to a Company**.

3.2 Restrictions on Foreign Lenders Receiving Security

The granting of security or guarantees is not restricted. However, there are certain corporate limitations that govern the granting of security or guarantees. In accordance with the Portuguese Companies Code (PCC), companies can only grant guarantees or security to third parties provided that they:

- have a justified corporate self-interest; or
- are in a control or group relationship with the beneficiary of the security or guarantees.

Furthermore, the PCC includes a prohibition on financial assistance (see **5.4. Restrictions on the Target**).

For tax purposes, secured obligations are typically limited to an agreed maximum amount, which is usually linked to the value of the asset being encumbered or to the intrinsic value of the Portuguese target or subsidiary company.

3.3 Restrictions and Controls on Foreign Currency Exchange

There are no restrictions or controls regarding foreign currency exchange and there is no limitation on the expatriation of dividends or investments abroad. However, certain financial transactions are subject to reporting obligations to the Bank of Portugal and to the standard anti-money laundering (AML) regulations.

3.4 Restrictions on the Borrower's Use of Proceeds

Apart from those already mentioned, there are no restrictions on how a borrower may use the proceeds from a loan or debt security. However, it should be noted that it is market practice to stipulate contractually that the capital granted to a borrower may not be used for any other purpose than that specified in the facility agreement.

3.5 Agent and Trust Concepts

Portuguese law does not recognise the concept of parallel debt or of trusteeship. Therefore, the beneficiary of the security needs to have a valid underlying obligation duly secured by the security and, accordingly, the lenders would, in principle, need to be registered as holders of the security.

However, the security agreement and/or indenture, as well as the intercreditor agreement, usually state that the security should be granted to, and enforced by, the security agent in its capacity as agent (acting on behalf of the other secured creditors) and a joint and several creditor thus entitling it, as sole beneficiary of the security, to enforce the same. Consequently, it may be necessary to demonstrate that the security agent has been duly and expressly authorised for this purpose by each of the creditors.

Alternatively, the lenders may request to have the security registered in their own name to be able to enforce it directly.

3.6 Loan Transfer Mechanisms

Loans can be transferred through the assignment of credits or through the assignment of contractual positions.

Usually, parties prefer the assignment of credits mechanism, which, contrary to the assignment of contractual position, does not require the consent of the borrower. There can be limitations established for the assignment, including those related to tax (given that foreign lenders may be more expensive in terms of taxation if there is a gross-up obligation) and regulatory requirements.

The assignment is made by private contract between the assignor and the assignee, and it involves the transfer of the security package that is associated with it. If the security includes mortgages, a public deed or private document with signature recognition is required as a formality for the transfer. Depending on the type of security, further steps for the transfer may be required, including registration with the real estate registry office for mortgages, registration with the bank for bank account pledges or registration with the commercial registry for quota pledges.

3.7 Debt Buy-Back

A debt buy-back by the borrower is typically not allowed, as it may trigger a subordination of the

debt in the case of insolvency. Alternatively, and as a way of overcoming this limitation, the borrower is usually entitled to repay the loan early, partially or in full.

3.8 Public Acquisition Finance

There are no specific rules regarding "certain funds" similar to those contained in the City Code on Takeovers and Mergers.

An offeror in a public takeover bid is only required to have the funds deposited or to present a bank guarantee for payment when applying for the registration of the takeover bid with the Portuguese Securities Market Commission. There can be debt financing for the consideration of the offer, but such a financing must always be in the form of a bank guarantee or a deposit in favour of the target company's shareholders. Thus, in such cases, there will need to be a direct commitment of the lenders towards those shareholders.

In addition, when public takeover bids are at stake, there is usually a financial intermediary (although this is no longer mandatory) that coordinates all financial arrangements with the offeror. Due to the above, "certain funds" provisions are not commonly used in public acquisition finance transactions.

3.9 Recent Legal and Commercial Developments

The major change in recent years with significant impact on legal documentation was Decree Law No 75/2017, which allowed for appropriation on commercial pledges, provided that there is an evaluation of the asset in accordance with the terms and criteria established in the pledge agreement. This allowed for pledges that could not benefit from the financial collateral regime, but qualify as commercial pledges, to be enforced through appropriation, provided that this is provided for in the security agreement.

Another recent trend is the insertion of ESG covenants in the legal documentation.

3.10 Usury Laws

In addition to the criminal framework, the Portuguese Civil Code (CC) stipulates that any loan agreement with an annual interest rate higher than the legal interest rate (currently 4% and 11% for civil and commercial contracts respectively), plus 3% or 5% (depending on whether or not there is an in rem guarantee), is considered a usurious agreement. Additionally, whenever the interest rate exceeds this threshold, it is reduced to that level.

The CC also establishes a generic prohibition against usury, whereby an agreement is void as a result of usury when someone, exploiting a situation of need, inexperience, dependency, mental state or weakness of character of others, obtains the promise or granting of excessive or unjustified benefits.

Regarding consumer credit agreements, Decree Law No 133/2009 considers, among others, an agreement to be usurious whenever the overall effective annual rate (TAEG) at the time of the conclusion of the agreement:

- exceeds by 25% the average TAEG applied by credit institutions in the previous quarter for each type of credit agreement for consumers; or
- exceeds by 50% the average TAEG for consumer credit agreements entered into in the previous quarter.

Any interest rate above the legal thresholds is automatically reduced to half of the maximum

limit, without prejudice to criminal or administrative liability.

Finally, it is worth noting that the Decree-Law No 58/2013 limits the default interest rate to be applied by credit institutions and entities licensed for credit activity to 3%.

3.11 Disclosure Requirements

There are no disclosure requirements for financial contracts, except in case of an offer of bonds to the public or in the context of a public takeover bid.

4. Tax

4.1 Withholding Tax

In accordance with Portuguese Corporate Income Tax (CIT) rules, interest owed by Portuguese residents to non-resident entities is subject to final withholding tax at the domestic rate of 25% over the interest gross amount.

The domestic withholding tax rate may, however, be reduced pursuant to the provisions of a double taxation agreement concluded between Portugal and the country of residence of the lender, typically to 10% or 15%.

Notwithstanding, interest derived from loans granted by non-resident financial institutions to resident credit institutions is exempt from withholding tax to the extent that the interest is not allocated to a local permanent establishment of the non-resident creditor. This exemption is not applicable if:

- the recipient of the interest is resident in a "tax-blacklisted jurisdiction"; or
- the recipient of the interest, without a permanent establishment in Portugal, is held, directly or indirectly, in a greater than 25% shareholding, by resident entities, except when the entity is resident in another EU country, in an European Economic Area (EEA) country bound by fiscal co-operation identical to the one established within the EU or in a country that has concluded a double tax treaty with Portugal providing for exchange of information.

Non-residents may also benefit from an exemption from withholding tax on interest derived from listed bonds, as provided in Decree Law No 193/2005 (which also allows for an exemption from capital gains upon disposal of the bonds). See **4.2 Other Taxes, Duties, Charges or Tax Considerations** for stamp duty on issues of bonds.

In summary, and to the extent that the necessary requirements regarding the beneficiaries (ie, bondholders) are met, no withholding tax applies over the interest, provided the necessary formalities are completed, namely, proof of the beneficiaries' non-residence status and the information about the debt securities and beneficiaries are provided.

The bonds must be integrated in a centralised system managed by an entity resident for tax purposes in Portugal (ie, Interbolsa), or an international clearing system managed by an entity located in another EU member state (such as Euroclear and Clearstream Luxembourg) or in an EEA member state, provided it is bound by an administrative co-operation in tax matters similar to the one established within the EU or integrated with other centralised systems. In this last case, the competent government member must authorise the application of the special tax regime.

The Court of Justice of the European Union ruled that the Portuguese domestic CIT rules imposing withholding tax over interest obtained by non-residents were in breach of EU Law, based on the fact that the withholding tax is based on the gross amount of the interest, whereas resident financial institutions (only) pay tax on their net income (decision of 13 July 2016, on Brisal – Auto Estradas do Litoral SA, KBC Finance Ireland v Fazenda Publica – Case C-18/15). While it was expected that this decision would determine tax rules, this has not been the case to date.

The reimbursement of the principal and other payments to lender are not subject to Portuguese withholding tax.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Value-Added Tax (VAT)

Financial transactions are, as a rule, exempt from VAT under domestic VAT law. This exemption notably covers the granting and negotiation of credit, the respective administration and management by the entity granting the credit, the negotiation and granting of security and guarantees, and transactions (including negotiation) related to the deposit of funds, current accounts, payments, transfers, collection and cheques.

The VAT treatment of bank commissions and fees is determined on a case-by-case basis, depending on their particular features, although those commissions corresponding to the above transactions are in principle VAT-exempt.

Conversely, other commissions or fees charged by the banks – eg, for consultancy, certain structuring and settlement services – are in principle out of the scope of the referred exemption and are hence liable to VAT taxation. Where these fees are charged by non-resident banks to Portuguese VAT taxpayers, Portuguese VAT will apply by means of the "reverse charge mechanism".

Financial transactions subject to, but exempt from VAT, are subject to stamp duty.

Stamp Duty

Portuguese stamp duty is due on a list of specified taxable events when deemed as occurring in Portugal, including several transactions, contracts, acts and documents, as outlined in the stamp duty chart, including financial transactions. However, no stamp duty is levied over transactions subject to and not exempt from VAT – eg, certain services provided by banks, as referred to above.

The grant of credit is subject to stamp duty, levied over the principal at rates that vary depending on the term during which the credit is used, as follows:

- credit for less than one year – 0.04% per month or fraction thereof;
- credit for one or more years – 0.5%; and
- credit for five or more years – 0.6%.

The extension of the term of the contract constitutes a new granting of credit, which raises additional taxation with stamp duty borne by the borrower. No stamp duty, however, applies in the case of funding obtained through the issue of bonds over the principal or interest (see taxation of interest below).

The granting of security is also subject to stamp duty whenever it is:

- granted in the Portuguese territory;

- for the benefit of a Portuguese resident entity; or
- herein presented to produce legal effects, except if it is materially accessory to a taxable stamp duty event; and
- granted simultaneously with it.

Stamp duty is borne by the entity required to present the guarantee (ie, the debtor). Accordingly, security granted in the context of a loan agreement tends not to be subject to stamp duty, as the use of credit under the loan agreement will itself be subject to taxation – provided that the conditions mentioned in the first and second bullet above are met – such as in the case where a Portuguese company borrows funds from a non-resident bank. In the case of issuance of bonds, the security granted for the benefit of the relevant bondholders may trigger Portuguese stamp duty.

When due, the stamp duty taxable basis is the value of the underlying security (ie, maximum secured amount). The effective tax rate, depends on the applicable term, as follows:

- security with a term of less than one year – 0.04% per month or fraction thereof;
- security with a term equal to one year and up to five years – 0.5%; and
- security with a term equal to or over five years or without any specific term – 0.6%.

In the case of transactions carried out by or with the intermediation of credit institutions, financing companies or other entities legally equated to them, or any other financial institutions, interest is also subject to stamp duty over the respective amount at a rate of 4%, as well as commissions and other bank fees over the respective amount at a rate of 3% (commissions for guarantees), or 4% (other commissions and fees for financial services).

As outlined above, no stamp duty is levied over operations subject to and not exempt from VAT – eg, those bank commissions subject and not exempt from VAT.

Notwithstanding the above, an exemption applies to interest and commissions charged, security granted, as well as to the use of credit granted by credit institutions, financial companies and financial institutions to venture capital companies and also applies to companies or entities the form and object of which corresponds to those of credit institutions, financial companies and financial institutions as provided in EU Law, both domiciled in the EU member states or in other states, with the exception of jurisdictions with a more favourable tax regime as defined by Ordinance No 150/2004 of the Ministry of Finance (as amended).

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Portuguese tax implications applicable to foreign lenders or non-money bank lenders should follow, in general terms, the regime described in **4.1 Withholding Tax** and **4.2 Other Taxes, Duties, Charges or Tax Considerations**.

In any case, the qualification (or not) of lenders as financial institutions should be taken into consideration, as the applicable tax regime may differ depending on such qualification. For instance, as detailed in **4.2 Other Taxes, Duties, Charges or Tax Considerations**, commissions/other remuneration for financial services should only be subject to stamp duty if the relevant services are granted by or with the intermediation of credit institutions, financing companies or other

entities legally equated to them, or any other financial institutions.

5. Guarantees and Security

5.1 Assets and Forms of Security

The typical Portuguese collateral package includes:

- mortgages over real estate properties in Portugal;
- pledges over the shares/quotas of material guarantors or financed companies;
- pledges over fixed movable assets (namely stock, equipment or inventory);
- pledges over bank accounts;
- pledges/assignments over intercompany receivables;
- pledges/assignments of receivables; and
- pledges/assignments over insurance policies and, in some cases, intellectual property rights (ie, patents, trade marks).

Security over real estate assets is less frequent, except on project finance or real estate transactions or where real estate is the key asset of the guarantor/financed company. In certain financing transactions (eg, vessel and aircraft financing), security is taken over the financed assets.

If the requirements are met, the lenders will use the financial collateral regime, such as bank account pledges or share security.

Formalities

Formalities vary significantly according to the type of security.

In terms of documentation, mortgages over properties and banking pledges require a public deed or a document authenticated by a notary. Conversely, bank account pledges and share pledges require only a simple private document, except for commercial pledges with appropriation (which require a certification of signatures). In any case, public deeds or notarial authentication are usually recommended in order to serve as judicial enforcement titles.

In terms of possessory or similar actions, the creation of a pledge over movable assets requires the asset to be delivered to the creditor (unless the pledge at stake is a banking pledge). Assignments of receivables and pledges over credits must be notified to the respective debtors.

In most cases, taxation (stamp duty) is the most significant cost, while notarial costs are not significant.

Registration

The registration requirements also vary with the type of security at stake.

Pledges over bank accounts require a registration with the bank with which the account is held.

Pledges over shares are subject to registration with the issuer (in the shares' registry book and inscription of the pledge in the share certificates) in the case of shares represented by certificates, or subject to registration with the relevant depositary bank in the case of deposited shares, or with the relevant financial intermediary with which the shares are registered in the case of dematerialised shares (regardless of being integrated in a centralised clearing system).

Pledges over quotas are subject to registration with the commercial registry.

Mortgages over properties or registrable movable assets – such as aircraft, vessels, vehicles

– are subject to registration with the competent registry office (real estate or other).

Registration costs are not material.

5.2 Floating Charges and/or Similar Security Interests

A floating charge or any other universal or similar security interest cannot be granted over all of a company's present and future assets. Security is granted over specific assets, which need to be identified. Security over future assets can be granted to the extent that they are identifiable, although there are further limitations depending on the type of security. However, some authors argue the admissibility, even if in a limited way, of floating charges.

5.3 Downstream, Upstream and Cross-Stream Guarantees

In accordance with the PCC, downstream, upstream and cross-stream guarantees are allowed, provided that certain requirements are met. However, a few scholars have argued that in cases where there is only a dominant influence (capable of originating a "de facto group"), upstream guarantees are not allowed, due to the lack of legal protection of the controlled company.

As previously mentioned, Portuguese companies must have a justified corporate self-interest in granting guarantees or security to third parties or otherwise be in a group or control relationship with the beneficiaries (see **3.2 Restrictions on Foreign Lenders Receiving Security**).

Usually, cross-stream guarantees cannot fulfil the requirement of the group or control relationship. As such, they need to meet the requirement of the justified corporate self-interest, otherwise they will be null and void.

5.4 Restrictions on the Target

The PCC provides for a prohibition of financial assistance. The target company is prohibited from granting any type of guarantees or security or any other types of funding in respect of any financing for the purposes of acquiring shares in the target company or in its direct or indirect parent company. This shall also include any guarantees or security for the refinancing of a previous debt incurred in the acquisition of shares of the target company or its parent company.

Breach of the financial assistance prohibition renders the respective guarantees, security, financing or funding made by the target company null and void. In addition, directors may incur civil and criminal liability. For this reason, it is common to include guarantee-limitation language in a guarantee or security agreement.

5.5 Other Restrictions

The parties usually agree, for tax reasons, to limit the maximum amount secured by the guarantees or security in order to limit the impact of stamp duty that is due in connection therewith (see **4.2 Other Taxes, Duties, Charges or Tax Considerations**).

In the event that the assets of the Portuguese companies are covered by legal immunities, namely, public domain assets of the Portuguese Republic, or are allocated to any public service purposes, those companies can claim immunity from suit, attachment or other legal process in respect of this.

Finally, any guarantee or security must guarantee or secure one or more obligations, to which they are ancillary, and such obligations shall be identified in the guarantee or security agreement. Accordingly, the guarantee/security will always follow the underlying secured obligation.

As such, the invalidity of the underlying obligation would entail the invalidity of the guarantee/security and termination of the underlying obligation would entail termination of the guarantee/security.

5.6 Release of Typical Forms of Security

Guarantees and security are ancillary to the guaranteed or secured obligation and thus the repayment, satisfaction or cancellation in full of such obligations automatically determines the release of the guarantees or security.

Nonetheless, it is market practice to execute a formal release agreement in order to obtain all necessary documentation from the lenders that allows perfection of the release of the security with the relevant authorities. This is particularly relevant if the security had been registered with a real estate or commercial registry office (mortgages and quota pledges) or with a bank (bank account pledges). Other actions such as notices, return of share certificates and cancellation of registrations may also be required, depending on the type of security that is being released.

5.7 Rules Governing the Priority of Competing Security Interests

As the priority of competing security interests is determined by the date of registration of the security interest (registration priority principle) if the security is subject to registration–mortgages on properties, vessels, aircraft, factory and car mortgages, quota pledges, pledges over bank accounts and pledges over deposited and dematerialised shares are all examples of security interests that are subject to registration.

Conversely, if no registration is required but merely the transfer of possession (eg, assignment of receivables), priority is determined by the date on which the relevant perfection requirements of the security are completed, namely, the act of possession by the creditor or similar (eg, notification to debtors in an assignment of receivables).

Contractual subordination is allowed under Portuguese law. Creditors may qualify their debt as subordinated and have it treated as such in an insolvency proceeding. However, contractual subordination is only recognised if it is made before all creditors (eg, deeply subordinated debt) and not just before certain creditors (eg, mezzanine debt), because insolvency law has general classes of creditors (see **7. Bankruptcy and Insolvency**).

Therefore, waterfall provisions of intercreditor agreements are not recognised in insolvency proceedings and distributions may have to be redirected amongst creditors after receiving the proceeds in an insolvency proceeding to comply with intercreditor agreements.

Under Portuguese law, structural or legal subordination resulting from law is also permitted.

5.8 Priming Liens

The "*privilégios creditórios*" are statutory liens that allow for the respective creditor to be paid preferentially to other creditors. They result directly from the law and can be of two types:

- real estate statutory liens:
  - (a) generic ("*privilégios imobiliários gerais*") – they encompass all the properties of the debtor in general and they are established, for example, in favour of certain tax credits and certain social security credits;
  - (b) specific ("*privilégios imobiliários especiais*") – they refer to a specific property and they are foreseen to secure, eg,

credits of employees performing their work in the property, credits regarding real estate transfer tax or real estate property tax; and

- moveable assets statutory liens:
  (a) generic ("*privilégios mobiliários gerais*") – again they encompass all moveable assets of the debtor and are established to secure certain tax credits and certain credits of the social security and the employees; and
  (b) specific ("*privilégios mobiliários especiais*") – they refer to a specific moveable asset of the debtor and they are foreseen to secure, eg, credits arising from judicial expenses.

The real estate special statutory liens rank senior to any mortgage even if the mortgage was granted prior to the creation of such statutory lien.

As a general rule, the general statutory liens and the moveable assets special statutory liens should not prevail over security already existing over the asset at the time of their creation, although there are some exceptions.

Retention rights over real estate assets (eg, constructor's retention rights) also rank senior to mortgages even if the latter are granted prior to the former.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Security interests are usually enforced by the secured parties directly (if lenders hold the security directly and retain the enforcement right) or by the security agent upon the occurrence of an enforcement event following an instruction of all or the majority of lenders.

Early termination clauses based exclusively on the declaration of insolvency are generally not allowed, but the Portuguese Insolvency Code expressly allows early termination in situations preceding the declaration of insolvency.

Enforcement procedures vary significantly, depending on the type of security. The enforcement of mortgages is subject to a judicial enforcement proceeding, and no private or out-of-court enforcement is allowed.

The general rule is that appropriation by the creditor is not allowed; therefore, enforcement requires a court sale or an extra-judicial sale. However, the financial collateral arrangements regime and Decree Law No 75/2017 on commercial pledges allow for an appropriation of the asset in certain conditions.

Finally, assignment of receivables only requires a notification to the debtor/client of the borrower or guarantor to make payments directly to the secured parties.

Borrowers or guarantors usually grant irrevocable powers of attorney in favour of the security agent to create additional security over the new assets or to enforce security and sell the assets upon the occurrence of an event of default.

6.2 Foreign Law and Jurisdiction

The choice of a foreign law is valid, recognised and enforceable under Portuguese law, unless there is a mandatory provision that determines the applicability of Portuguese law, in accordance with Regulation (EC) No 593/2008 on the law applicable to contractual obligations ("Rome I").

The submission to a foreign jurisdiction is also valid, recognised and enforceable under Portuguese law, provided that the exclusive jurisdiction provisions, set forth in Council Regulation (EC) No 1215/2012, are complied with.

A waiver of immunity is also recognised, except where, as previously mentioned, the assets are in the public domain ("*bens do domínio público*") or allocated to public interests or owned by states and diplomatic entities.

6.3 Foreign Court Judgments

Judgments rendered by EU Member State courts are enforceable in Portugal in accordance with the terms of Regulation 1215/2012.

Judgments rendered by foreign courts outside the EU, should there be no bilateral treaty, will also be recognised and enforced in Portugal according to the procedures set out in the Portuguese Civil Procedure Code on the recognition of foreign judgments, provided certain requirements are met.

In respect of foreign arbitral awards, the enforcement scenarios may vary, depending on the concrete situation and whether or not they are covered by the New York Convention or by any bilateral agreement.

6.4 A Foreign Lender's Ability to Enforce Its Rights

Aside from the above, there are generally no other matters which might impact a foreign lender's ability to enforce its rights under a loan or security agreement. However, all documents, including any enforcement titles, have to be translated into Portuguese.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

The declaration of insolvency triggers, in principle, the automatic acceleration of the liabilities of the insolvent entity. As such, there will be, in principle, an automatic acceleration of the loan.

In respect of guarantees, the declaration of insolvency gives rise to the automatic claw-back actions of:

- granting of security ancillary to pre-existing obligations, or others that replace them, within six months prior to the beginning of the insolvency proceeding;
- personal guarantees, sub-guarantees, sureties and credit mandates made within six months prior to the beginning of the insolvency proceeding and not corresponding to transactions with a real benefit for the insolvent entity; and
- granting of security simultaneously to the creation of the secured obligations within 60 days prior to the beginning of the insolvency proceeding.

These automatic claw-back actions do not apply to financial collateral arrangements, such as financial pledges. In addition to such automatic claw-back actions, the acts performed or omitted within the two years prior to the insolvency proceedings may generally be subject to claw-back if they are found to be detrimental to the insolvency and have been carried out in bad faith.

Additionally, enforcement of guarantees and security is carried out within the insolvency proceeding of the guarantor, except for, eg, financial collateral arrangements. Therefore, all future enforcement proceedings will no longer

be allowed and those currently pending will be suspended, and creditors will need to lodge their claims in the insolvency proceeding.

7.2 Waterfall of Payments

The Portuguese Insolvency Code provides for the following classes and ranking of credits:

- guaranteed credits – credits secured by security, including special statutory liens; accordingly, these include real estate special statutory liens (eg, state credits related to real estate property tax), third-party security rights (eg, mortgage, income assignment, pledge), and movable assets special statutory liens (eg, credits resulting from judicial costs);
- privileged credits – credits secured by general statutory liens over assets integrated in the insolvent estate up to the amount corresponding to the value of the assets that are the object of the guarantee or the general statutory liens; these include movable assets general statutory liens (eg, employment credits), and real estate general statutory liens;
- common credits – all credits not included in another class; and
- subordinated credits – namely interests and credits held by persons with special relations to the debtor (eg, controlling shareholder), directors or members of the supervisory board.

The payment will be performed according to the credit ranking: firstly, guaranteed credits, followed by privileged credits, then common credits and finally subordinated credits.

If the assets of the insolvent estate are insufficient to pay all creditors in full, the payment to common creditors will be made by apportionment amongst all creditors and in proportion to their credits.

The payment of subordinated credits will only take place after full payment of common credits.

7.3 Length of Insolvency Process and Recoveries

The duration of insolvency proceedings varies a lot (depending, eg, on the court at stake, the complexity of the insolvency, the creditors, the claims/oppositions). As a reference, the insolvency proceedings completed in the first quarter of 2023 had an average length of 71 months.

Recoveries would highly depend on the security and position of the relevant creditor, the assets and liabilities of the insolvent company and the type and number of creditors. As a reference, the credit recovery rate of the proceedings completed in the first quarter of 2023 was 8,5%.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

There are two main recovery procedures outside an insolvency proceeding: “Out-of-court Recovery Proceeding” (RERE) and the “Special Revitalisation Proceeding” (PER).

The RERE is an extra-judicial voluntary mechanism aimed at allowing the recovery of companies in financial difficulties or imminent insolvency through negotiations with creditors for its revitalisation. The company and creditors, representing at least 15% of the company’s liabilities (non-subordinated), must sign a negotiation protocol and deposit it with the commercial registry. The agreement reached will have some similarities to the agreement in a PER, although the RERE (contrary to the PER) does not provide for the cramming down of the non-participant creditors.

The PER aims at allowing debtors in financial difficulties or imminent insolvency, but whose

recovery is still feasible, to negotiate with creditors an agreement for the revitalisation of the company, which, if approved by the creditors and homologated by the court, will bind all creditors.

A PER is deemed approved in the following situations.

- In case creditors are classified in different categories (a new concept introduced by Law no. 9/2022), it is voted in favour in each of the categories by more than 2/3 of all votes cast, thus obtaining:
  (a) the favourable vote of all categories;
  (b) the favourable vote of the majority of the established categories, provided that one of the said categories is composed of secured creditors;
  (c) in the event there are no secured creditors category, the favourable vote of the majority of the established categories, provided that, at least one of said categories is composed of non-subordinated creditors; and
  (d) in the event there is a tie, the favourable vote of, at least, a non-subordinated category.
- In the remaining cases, when it is voted by creditors whose credits represent at least 1/3 of the total number of claims with voting rights, the plan is approved if it obtains:
  (a) the favourable vote of more than 2/3 of the votes cast; and
  (b) the favourable vote of more than 2/3 of the votes cast; and
  (c) the favourable vote of more than 50% of the votes cast pertaining to non-subordinated credits with voting rights.
- When the recovery plan receives:
  (a) the favourable vote of creditors whose claims represent more than 50% of all claims with voting rights; and
  (b) the favourable vote of more than 50% of the votes issued pertaining to non-subordinated credits carrying voting rights as listed in the provisory credits list.
- When the recovery plan receives:
  (a) the favourable vote of creditors whose claims represent more than 50% of all claims with voting rights; and
  (b) the favourable vote of more than 50% of the votes issued pertaining to non-subordinated credits carrying voting rights as listed in the provisory credits list.

Finally, there is the Legal Framework for Conversion of Debt into Equity that allows companies in a negative equity position to restructure their balance sheet and strengthen equity by conversion of debt.

7.5 Risk Areas for Lenders

In case a borrower, security provider or guarantor is declared insolvent, the most relevant risk for lenders is the possible claw-back of the agreements entered into between the lenders and the insolvent entity, namely for the granting of guarantees or security, under the terms detailed in **7.1. Impact of Insolvency Processes**.

Furthermore, and in addition to the recoverability risks (which are assessed on a case-by-case basis, considering the assets and liabilities of the debtor, the security benefiting the lenders and the range of creditors), lenders will also face a recovery timing issue: unless they benefit from financial collateral, security and guarantees have to be enforced within the insolvency procedure, which, as mentioned in **7.3. Length of**

Insolvency Process and Recoveries, may take a long time.

8. Project Finance

8.1 Recent Project Finance Activity

After a decade of lower project finance activity in Portugal (including due to restrictions on public investment following the sovereign debt crisis), there has been an increase of activity in recent years, especially in the renewable energies sector (in line with the promotion of energy transition).

The National Investment Plan 2030, which defines the structural investment priorities for this decade, and the Recovery and Resilience Plan presented by the Portuguese government within the framework of the EU Recovery and Resilience Mechanism also create a new incentive for public investments and public-private partnerships, as well as new opportunities for project financing. In this context, sectors associated with innovation, greener production and digital tools and skills, are the major beneficiaries of the expected public investment and, as such, should be more active. Nevertheless, the recovery plan also envisages relevant investment projects in health, social housing and infrastructure.

In parallel, the project finance sector in Portugal is also witnessing in recent years several refinancing transactions for existing project debt, which do not follow the standard project finance approach.

8.2 Public-Private Partnership Transactions

The PPP legal framework is based on the Portuguese Public Contracts Code (PPCC) and the PPP laws.

Portuguese PPPs typically follow project finance structures with a build-operate-transfer (BOT) model. The concession agreement regulates the major contractual issues of the PPP, namely, the terms on which the project company will construct the project and operate it as well as the payment terms associated with the PPP. In addition to the concession agreement, the remaining documents that comprise the PPP package are also attached: the equity subscription agreement, the shareholder agreement, the direct agreement, the construction contract, the operation contract and the financial documents.

Before launching and awarding the PPP, the environmental impact declaration and urban planning licences need to be issued. An environmental licence may also be required for certain industrial projects.

Under PPP laws, the risks of the project shall be clearly contractually identified, and its allocation shall be made in accordance with each partner's ability to manage it. Nonetheless, the partnership must also involve a significant and effective transfer of risk to the private partner, particularly the financing risk.

The financial rebalancing, as the main mechanism covering project risks, remains with the public contracting entity.

Following the execution of the PPP contract, and prior to its entry into force, the Court of Auditors will review the agreement. The acts, contracts and other instruments subject to the previous auditing by the Court of Auditors may produce its findings prior to the visa, except in respect to payments resulting from such acts, contracts or instruments being audited.

8.3 Governing Law

Portuguese law is mandatorily applicable to concession agreements and other project documents related thereto entered into with public entities. With respect to agreements entered into with private entities, parties are free to choose the governing law, pursuant to the Rome I regulation. Portuguese courts will uphold the applicability of the law specified as governing such agreements, unless such applicability would be illegal or would contravene Portuguese public policy principles, or unless it relates to foreclosure procedures occurring in Portugal, in which case Portuguese law shall apply.

International arbitration may be used to settle disputes, although, in the case of concession agreements and other project documents related thereto entered into with public entities, the submission to international arbitration may be subject to certain requirements.

8.4 Foreign Ownership

Except for public domain assets, which are not capable of being appropriated by private entities, the ownership of real property (or the exercise of remedial rights on liens on such property) does not require a permit, licence or an administrative consent, apart from those required by normal urban planning regulations.

Concerning water resources, their use, regardless of foreign ownership, is subject to a licence, an authorisation or a concession (depending on certain requisites, namely the volume used). They are usually attributed through a public tender and subject, in some cases, to prior environmental assessments and other town planning regulations, which sometimes disallow specific uses in protected areas or zones with special scarcity. The transmission of a public domain water resource title is also subject to an authorisation (including in change of control situations) and the transmission of a private domain water resource title is subject to a prior communication, both being subject to certain conditions.

The works and buildings placed on the hydric domain cannot be transmitted, directly or indirectly, nor can they be encumbered or mortgaged, without an authorisation from the competent authority for the water resources title.

Restrictions arising from Regulation (EU) 2019/452 and Decree-Law 138/2014 mentioned in **8.7. Natural Resources** should also be taken into account.

8.5 Structuring Deals

Project finance structures in Portugal are similar to those used internationally. A special-purpose vehicle (SPV) is usually incorporated as a share company. The financing structure is usually a loan, although bond structures are also used when there is international financing involved or there is the participation of funds that, for regulatory reasons, cannot grant loans. Monoline structures are less common but they were successfully used in the past. The loan structures can have different types of facilities for working capital, letters of credit or banking guarantees, liquidity, VAT or long-term loans, and can be granted by one or two banks, or they can be club deals, depending on the size of the financing. In certain projects, there can also be a credit agreement with the European Investment Bank (EIB).

There is typically a full security package which, however, limits the recourse to the project, project assets and project documents (such as the construction and operation contract). Apart from the pledge of shares of the SPV, the security package is not available to shareholders of the project company, which usually have their

liability limited to certain amounts in relation to their respective participation in the share capital of the project company.

The laws relevant to the project depend on the project at stake. In the energy sector, the energy legal framework is of utmost importance and the lenders usually try, for example, to obtain certain protection on the reduction of feed-in tariffs. In the transportation and infrastructure sector, the concession agreement is usually the main legal document to consider.

There are no relevant limitations on foreign investment, except for energy and certain other sectors.

8.6 Common Financing Sources and Typical Structures

Export credit agency financing is not that common in Portugal, although it has increased in the last few years. It is common to have financing coming from both commercial banks and the EIB, which requires the structure to be properly modelled to ensure a higher ranking for EIB debt and, usually, guarantees from the commercial banks of the bank financing. The use of project bonds is not common but they have been used successfully in certain project finance deals. In the past, monoline structures were commonly used, particularly in railway and subway financing contracts, but nowadays they are much less prevalent.

In recent years, particularly due to the banking crisis, investment funds have become active in this sector using alternative funding structures, as is the case for bond issuances.

8.7 Natural Resources

The ownership of hidden mineral resources is vested in the State. Any entity that is interested in searching for or exploiting such resources needs to obtain an adequate licensing or concession title. The type of title that is required can vary, depending on the type of resource sought and also on the type of activity. Usually, mere exploration requires a simple licence, while exploitation will necessarily imply a concession. Mining rights can be acquired by direct negotiations with the licensing authority. However, in the case of oil and gas rights, there has been an indication that future rights will only be awarded as part of a competitive bidding process.

The exploration and exploitation operations require prior adequate environmental assessment, subject to public discussion. Any protective or remedial actions that are identified as necessary are exclusively the responsibility of the licensee. Also, environmental rules on the protection of landscape are mandatory and must be implemented including after the operation. On oil and gas operations, an investment plan is needed.

The licensee is entitled to take and dispose of the production resulting from their activity, except for any quantities that may be due to the state as royalties that the state decides to take in kind. Exports are not subject to any specific duty or tax and are free, except as may otherwise be regulated by sanctions adopted by the UN or the EU, or by another competent international organisation. Exports in mineral resources can only take place when arising from an authorised operation or if they were legally imported.

One should consider the restrictions that may arise under Regulation (EU) 2019/452 (the “FDI Screening Regulation”), as well as under Decree-Law 138/2014, which establishes a safeguard regime regarding key strategic assets to ensure the security of national defence and safety and

the provision of fundamental services in the national interest in the areas of energy, transport and communications, and sets out specific restrictions on foreign investment by overseas entities (from outside the EU and the European Economic Area). Such restrictions are considered on a case-by-case basis, through the verification of certain criteria, following which the Portuguese Council of Ministers may oppose the completion of the relevant transaction over such key strategic assets.

8.8 Environmental, Health and Safety Laws

Projects may be subject to environmental impact assessment, to environmental incidence assessment and sometimes to environmental licensing.

The main environmental legislation applying to projects is the following:

- Law No 19/2014, which enacts the Environmental Bases Policy;
- Decree Law No 151-B/2013, which sets forth the legal regime for the Environmental Impact Assessment; and
- Decree Law No 127/2013, together with Decree Law No 75/2015, which regulate administrative proceedings related to the grant of pollution and emissions licences for several activities.

The regulatory body that oversees environmental law is the Portuguese Environment Agency, which is an independent administrative entity supervised by the Environment Ministry.

Decree Law No 273/2003 established the prerequisites regarding health and safety in projects that entail construction. It requires the use of a health and safety plan as well as the appointment of a safety co-ordinator, both during the drafting of the project and later during its execution. The Authority for Work Conditions is responsible for the control of the aforementioned requirements.

In order to obtain and maintain a permit to perform public or private works, an insurance for work accidents is required, the existence of which is supervised by the IMPIC ("*Instituto dos Mercados Públicos, do Imobiliário e da Construção*"). In turnkey or concession contracts, additional rules regarding health and safety can be included.

Trends and Developments

Contributed by:
Hugo Nunes e Sá
PLMJ

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Author

Hugo Nunes e Sá is a senior professional support lawyer in the Banking and Finance and Capital Markets practices at PLMJ. With 16 years' experience, he has focused on corporate finance, sale and acquisition of loan and property portfolios, issuance of debt and hybrid securities, mergers and acquisitions and investment funds. Hugo worked mainly with credit institutions, listed companies, investment firms and financial companies. He was an assistant to the Secretary of State for the Treasury of the 19th Constitutional Government of Portugal.

PLMJ

PLMJ Advogados SP, RL
Av. Fontes Pereira de Melo, 43
1050 119
Lisboa
Portugal

Tel: +351 213 197 300
Email: plmjlaw@plmj.pt
Web: www.plmj.com/en

An Introduction to and Snapshot of the Portuguese Economy and the Banking Sector's Performance

Introduction

After facing the setbacks of the pandemic, Portugal's economic activity not only rebounded but also surpassed its pre-pandemic levels. The first quarter of 2023 saw robust growth of 1.6%. If this trend persists, the country is poised to achieve an annual growth rate of 2.1% by the year's end. Remarkably, Portugal's growth since 2020 has outpaced many of its peers in the eurozone.

However, challenges remain. Inflation, although it is now on the decline, is still at elevated levels. Several factors contribute to this, such as the Ukraine conflict (which played a role by driving up energy and food prices), the persisting global supply issues, and renewed demand as the economy recovers. All this has further stoked the existing inflationary pressures.

Households in Portugal may have seen some hint of relief with a rise in disposable income – a result of increased wages and employment opportunities (employment figures have rebounded, exceeding the levels seen before the pandemic), as well as government assistance at some levels. However, the pressure created by high inflation and interest rates represent challenging hurdles.

As a consequence of the aforementioned increasing rates, more households may face difficulty in servicing their mortgages by the end of 2023, especially those in lower income brackets. The number of firms struggling to cover their interest payments might also rise, although it is expected to stay below crisis-era levels. This may pose an additional challenge to the banking sector, regardless of its latest remarkable performance (as will be detailed further below and much as a result of the increased interest rates). There are cushions built within the banking sector during the pandemic in the form of deposits and profitability that, combined with government intervention at the household level, may offer a much required safety net to the solidity of the banking system as well as to more vulnerable sectors.

Thus, the future comes with its particular set of challenges: high inflation, stricter lending conditions, and diminishing recovery momentum might hamper growth. However, factors such as a strong job market, savings accumulated during the pandemic, government initiatives and funds from the EU may cushion these impacts.

In summary, while the Portuguese economy in 2023 reflects recovery and resilience, it is evident that careful and strategic navigation will be crucial to ensure stability and sustained growth.

Snapshot of the Portuguese banking sector

Portugal's major banks reported record profits of EUR1.99 billion in the first half of the year, with revenues surpassing EUR4.2 billion. As anticipated above, the rise in interest rates boosted the banking sector's performance, although it has also led to reductions in loans and deposits.

The profits of banks such as BCP, BPI, Caixa Geral de Depósitos, Novobanco and Santander Totta peaked to levels not witnessed since before the 2008 crisis. The difference in the impact the rise of interest rates has had on loans, on one hand, and on deposits, on the other, allowed banks' revenues to double between the months of January and June of this year.

However, net commissions, a key banking revenue source, decreased by circa 2%, to EUR1.2

billion. The sector's strong performance highlighted impressive profitability metrics, with Novobanco's Return on Equity (ROE) reaching 28%. Notably, the BCP's ROE soared from 2.4% the previous year to 16.8%.

Yet, rising interest rates have negatively impacted these banks' balance sheets, causing both loans and deposits to decline. Additionally, over 50,000 loans were renegotiated by banks, primarily proactively rather than under legal obligations to aid struggling families. This is also a sign of what may lay ahead.

The Asset Management Framework

In recent years Portugal has maintained a steady course with regard to the adoption of major amendments to its regulatory environment, limiting changes to structural legislation solely to where these were strictly necessary.

In 2023 there is a, dare we say, single major novelty that can be pointed out: the introduction of the new Asset Management Framework (RGA). The RGA introduced several changes to the regulatory framework of collective investment entities (OIC) in Portugal. These will require adaptation by market participants, namely management companies, depositories, and investors. The main changes brought to life by the RGA are outlined below.

The RGA introduced a new categorisation of management entities: (i) the collective investment scheme management company (SGOIC) and the venture capital company (SCR); and (ii) the large-scale or small-scale management company (SG). With classification as a small-scale SG, comes the possibility for management entities of benefiting from a more flexible regime that can be applied to their activity, namely the possibility to:

- hold their own portfolios;
- forgo a depository in the case of an alternative investment fund (AIF) managed by the small-scale SG exclusively directed to professional investors;
- waive certain rules regarding employee remuneration; and
- be subject to a simplified prior authorisation process (for new SGs).

The RGA also expands the scope of permitted activities for SGs and, in particular, for SGs authorised to manage AIFs, it waives the need to obtain separate authorisation to manage subtypes of AIF. On the other hand, SCRs can now manage not only venture capital entities but also other types of AIF (provided that at least one of the managed entities is qualified as a venture capital AIF).

The RGA provides for the application of the Portuguese Securities Code rules concerning the marketing of units/shares of collective investment schemes (OICs), particularly in respect of the information, safeguarding of clients' assets, suitability assessment, investor categorisation, intermediation contracts, and order reception. Thus, by virtue of the RGA the marketing of units/shares of these entities is now expressly subject to those conduct duties set out under the Portuguese Securities Code.

The RGA clarifies and sets out the requirement for the specific information documents, even in cases of AIF's exclusively targeted at professional investors.

Also for AIFs exclusively targeted at professional investors and managed by small-scale SGs, there is no longer a requirement for the AIF to have a depository (except in the case of third-country AIFs).

The RGA explicitly provides for the possibility of AIFs issuing bonds, which, at least in as far as it concerned AIFs in a contractual form (funds), was not previously possible.

The RGA also clarifies that the duration of fixed-term OICs can be extended one or more times and it is not limited to a period not longer than the initially set out. Similarly to the previous framework, participants who vote against the extension of the OIC's duration can redeem their respective units.

One of the main changes introduced by the RGA concerning real estate investment entities (now "real estate AIFs") relates to the elimination of special rules regarding assets and limits applicable to these collective investment schemes. However, existing restrictions on acquiring real estate under co-ownership remain. Similarly, the RGA no longer sets explicit debt limits for real estate AIFs.

As to venture capital AIFs the RGA sets out that they must invest at least 10% in shares issued by each of the entities in which they participate when the investment is applied to securities admitted to trading on a regulated market; it also removes the 50% limit on the acquisition of participation units issued by each of the funds under management.

The market

As to market trends, 2023 is proving to be a rather atypical year, most likely as a reaction to the novel context.

Fintechs – an unusual suspect driving the M&A of regulated entities

The Portuguese market has witnessed solid and generalised interest in fintech players. This interest has materialised in two main ways. On the one hand, players have been creating fintech hubs in Portugal. The interest resides both in taking advantage of a business-friendly context, but also in the technological know-how and tech-savvy entrepreneurial culture that is currently flourishing in Portugal.

On the other hand Portugal has also seen recent movement in the M&A of regulated entities (namely medium and small-sized banks) which has been fuelled by some foreign fintech's appetite for the Portuguese market.

Since the beginning of the year two banks' acquisitions were made public (even if still subject to regulatory approval). Rauva has acquired Banco Montepio Empresas – in essence this will correspond to an empty licence acquisition as all assets, debt, operation and workers will be transferred to Banco Montepio prior to execution. The other example is the Chinese-based, Hong Kong stock exchange-traded Vcredit, which has acquired Banco Português de Gestão (a transaction still subject to regulatory approval from the ECB).

There has also been some movement on acquisitions of virtual assets service providers, which together with the acquisition of the above-mentioned banks is a strong indication of resurgence of a usually not so hot market in Portugal – the M&A of regulated entities.

Credit funds

Credit funds are not a regulatory novelty. Not even in the Portuguese market. Their introduction into the Portuguese legal framework dates back to 2020. The real novelty is the creation of the first credit fund in Portugal and the first managing entity authorised to manage such funds and the intention (made public) of some known players to invest in this market.

If this trend continues it could represent a significant development and, most importantly, have a positive impact on businesses in the Portuguese market, which can take advantage of a new and diverse funding source. This will also likely impact banking activity which will have to take on additional competition in this respect, namely taking into account the growing pressure on traditional lending due to high interest rates.

Non-performing loans

The debt trading niche market is a usual suspect when pointing out particularly active markets in Portugal. This has been the case for many years and even during different economic and political contexts. However, during the last couple of years this market is yet to show the liveliness of old. Although there have still been some interesting transactions – it would be misleading to given the impression it has ground to a halt – nothing that comes close to the pre-pandemic movement.

However, the impact the acute rise in interest rates is already having on Portuguese households may trigger the resurgence of this market. Even with some government initiatives trying to cushion the blows thrown by high interest rates, it is likely that by the end of the year, or at least early to mid-2024, a number of Portuguese banks will be following this route to adjust their balance sheets.

Tourism, real estate and finance

The tourism sector has been one of the driving forces of the Portuguese economy and has also played a pivotal role in feeding other connected industries (especially construction). The post-pandemic era, and 2023 in particular, has shown this clearly.

Real estate finance transactions, particularly those linked to tourism assets, have become an increasingly evident trend in the Portuguese market.

One notable landmark transaction was Project Crow (the real estate deal of the year in Portugal), where the goliath north American fund Davidson Kempner acquired, inter alia, the venture capital fund (tourism linked, with high-value assets under management such as the Palácio do Governador and the Cascatas Golf & Resort Spa by Hilton) Fundo de Recuperação Turismo from several Portuguese banks (namely Novo Banco, BCP and Caixa Geral de Depósitos).

There have also been several smaller, more under the radar, but still high-value, transactions.

The market is in full force and ripe for both domestic and foreign investors to take their stab at it.

On the other hand and also taking advantage of the changes brought by the RGA, there has been an increased appetite to explore the benefits of the new framework applicable to real estate investment firms or real estate AIF's (namely the elimination of special rules regarding assets and limits and no explicit debt limits). This appetite will likely increase as investors become more aware of the applicable framework and the success of players already taking this course of action.

SINGAPORE

Law and Practice

Contributed by:
Liew Kai Zee and Bryan Chang
Shook Lin & Bok LLP

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Shook Lin & Bok LLP is a leading, full-service law firm in Singapore with a strong Asian presence and global reach. The firm has more than a century of rich legal heritage and today has a number of partners who are eminent lawyers in their respective areas of expertise. The firm's banking and finance practice is one of the largest in Singapore, which allows it to work on large and complex transactions, including acquisition financing, assets and asset-backed financing, project financing, property financing, Islamic financing, aircraft and ship financing, structured financing, mezzanine financing, cross-border financing, structured trade and commodity financing, debt restructuring, dividend recapitalisation and bilateral and syndicated loans. The team works closely with its regulatory, litigation and restructuring and insolvency practices, as well as other specialists, to provide holistic legal advice to its clients, comprising both local and international banks and financial institutions, as well as corporates.

Authors

Liew Kai Zee heads the banking and finance practice of Shook Lin & Bok. He has over 25 years of experience advising financial institutions and major corporates on a broad range of domestic and international financing, securitisation and debt restructuring. He has extensive experience advising on syndicated lending, structured finance, leveraged buyouts and acquisition finance, structured commodity and trade finance, Islamic finance, ESG finance, project finance, property development finance, vessel finance, REIT financing, cross-border finance, sale of debts, debt programmes, rated and unrated commercial mortgage-backed securities and securitisation programmes. Kai Zee also advises financial institutions on regulatory and compliance matters, and is the legal trainer for a number of banks in the region.

Bryan Chang is a partner in the banking and finance practice of Shook Lin & Bok. He has been involved in various banking and financial transactions including bilateral and syndicated lending, project finance, acquisition finance, vessel finance and receivables finance matters.

Shook Lin & Bok LLP

1 Robinson Road #18-00
AIA Tower
048542
Singapore

Tel: +65 6535 1944
Fax: +65 6535 8577
Email: slb@shooklin.com
Web: www.shooklin.com

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Thus far, 2023 has been a year of clashing signals, creating sustained but prudent activity. Healthy liquidity in the Singapore banking system has been tempered by concerns over sustained inflation and uncertainty over interest rates. Concerns over a recession have also led to a focus on quality assets and accordingly, cautious loan growth.

While not strictly regulatory, the growing understanding of the role that lenders can play in global sustainability efforts has also led to lending policies targeted at improving such efforts, whether through industry focus (such as renewables and the circular economy) or loan offerings (such as green and sustainability-linked loans specifically adapted for a broader range of industries).

1.2 Impact of the Ukraine War

Singapore in general has had limited direct exposure to the Ukraine war. The introduction of new sanctions was an immediate direct impact, but otherwise, the impact was primarily felt through knock-on indirect effects. The full impact of the war itself may have been somewhat weakened for geographically-distant jurisdictions with limited direct exposure in the context of economies emerging out of an extended pandemic, especially for industries particularly affected by COVID-19.

1.3 The High-Yield Market

In comparison to past years where adoption of unitranche and term loan B loan structures was gradual, 2022 saw an increased interest in such structures with the narrowing of pricing gaps between such structures and senior debt. While a number of significant Asian brand names have accessed term loan B markets for capital, these remain relatively rare in Singapore in comparison to senior debt.

Mezzanine and second lien financings continue to feature, with an uptick arising from the increased entry of investors into Singapore with a focus on, or mandates to invest in, such debt. Mezzanine and second lien debt backed by real estate assets remain particularly popular among lenders and investors.

1.4 Alternative Credit Providers

Alternative credit providers continue to flourish in Asia, providing loans not just for underbanked and new industry borrowers who may not be finding it easy to access bank debt. These have ranged from P2P lending structures, to private debt providers offering terms akin to senior debt, but focusing on emerging Asian economy borrowers with less access to traditional bank debt capital. Both inbound and outbound alternative credit have seen significant activity.

In particular, with start-ups and early-stage companies from the 2010s and 2020s maturing and finding dilution or downrounds in the current climate unpalatable, there has been a flurry of activity in alternative credit providers (including specialist investors, and investors with broadened mandates) stepping in to provide debt financing to such maturing companies where conventional bank financing would otherwise still be difficult to obtain.

1.5 Banking and Finance Techniques

Loan products and offerings have become increasingly tailored to the needs and requirements of industry.

ESG and sustainability-linked lending in Singapore have expanded significantly beyond traditional benchmarks for real estate industries to focus on targets reflective of the efforts of borrowers and the industry they operate in; examples include ESG targets on investments for financings offered at the fund level, to social sustainability targets (such as labour) for manufacturing and primary industries.

Late growth-stage start-ups have also enjoyed increased availability of debt funding at holdco levels in recognition of the multi-jurisdictional operations for many of these companies. Financial covenants are usually structured to allow for growth while still measuring financial health for debt service, with equity kickers also featuring. Where appropriate, such companies have also been able to tap into asset-based financing, particularly where lenders have now gotten comfortable around the contractual structures underpinning the cash flow and assets (such as receivables primarily derived from electronic transactions) where once such structures were traditionally limited to production of physical goods.

These have necessitated reconsideration, development and adaptation of conventional loan documentation to develop bankable loan structures reflecting the actual operational requirements and needs of principals.

1.6 ESG/Sustainability-Linked Lending

Previously focussed primarily on real estate, ESG and sustainability-linked lending in Singapore has grown to cover broader industries in recognition of the need for sustainability, and the role that financing plays in sustainability. Structures are based on the requirements of the Green Loan Principles and Sustainability-linked Loan Principles, and are heavily tailored to reflect meaningful goals for the particular industry in which a borrower operates.

Separate from product offerings, lenders in Singapore have also focussed financing efforts on industries which promote sustainability and ESG efforts including renewables, decarbonisation (such as adoption of electric vehicle fleets) and the circular economy.

More recently, there has also been some attention on social aspects of ESG, with some Social Loans being structured based on the Social

Loan Principles, particularly with a focus on healthcare.

2. Authorisation

2.1 Providing Financing to a Company

In Singapore, banks are generally required to be licensed under the Banking Act 1970, to operate banking and other businesses in Singapore permitted under its licence. Such licensed banks and other categories (eg, finance companies) are excluded from the Moneylenders Act 2008, which otherwise generally applies to regulating the business of moneylending in Singapore, unless exempted. Excluded moneylenders include any person who lends money solely to corporations.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

See **2.1 Providing Financing to a Company**.

3.2 Restrictions on Foreign Lenders Receiving Security

While there are no general restrictions on the granting of security or guarantees to foreign lenders, the terms of certain private agreements may impose conditions or restrictions. For example, taking security over industrial land leased from the Jurong Town Corporation (or over such leases) may be subject to a consent requirement from the Jurong Town Corporation if security is granted to persons that are not financial institutions permitted by the laws of Singapore to lend on such security.

3.3 Restrictions and Controls on Foreign Currency Exchange

While there is exchange control legislation in the Exchange Control Act 1953, the Monetary Authority of Singapore Notice 754 exempts all persons from the provisions, obligations, etc, imposed under various sections of the Exchange Control Act 1953.

3.4 Restrictions on the Borrower's Use of Proceeds

The use of proceeds is generally regulated by contract and is largely unrestricted. Some general restrictions against illegal purposes include use of the proceeds in breach of sanctions, anti-terrorism financing and anti-money laundering rules. Another important restriction would be financial assistance rules which prohibit a public company or a subsidiary of a public company in Singapore from taking financing to assist the acquisition of its shares or shares in its holding company. If the purpose of the loan or the loan itself was illegal or prohibited, it renders the loan unenforceable and there would generally be no recovery other than on a restitutionary basis under very limited and strict conditions (as set out in Ochroid Trading Ltd v Chua Siok Lui).

3.5 Agent and Trust Concepts

Agency and trust concepts are recognised in Singapore.

3.6 Loan Transfer Mechanisms

Loan transfers are primarily conducted by way of novation, and syndicated facilities would typically have a form of transfer certificate included to effect novations of debt. A secured syndicated facility would typically have a security agent or security trustee holding the benefit of such security for the pool of syndicated lenders. Other transfer mechanics include those common to

other jurisdictions such as risk- and other sub-participation mechanics.

3.7 Debt Buy-Back

Debt buy-back by the borrower or sponsor is generally regulated by contract. Loan documentation has seen an increased adoption of either an outright prohibition against sponsor buy-backs or disenfranchisement of sponsor-affiliated lenders, with an increased presence of both sponsor-affiliated lenders and sponsor buy-backs; the latter featuring also as part of certain debt restructurings, especially in recently beleaguered industries where conventional lenders have reduced their exposure.

3.8 Public Acquisition Finance

"Certain funds" provisions are common for public acquisition finance transactions in Singapore and are also adopted in the financing of the acquisition of private companies in Singapore in particular cases. Long-form documentation is commonly used for acquisition finance transactions (even at the term sheet stage, with long-form term sheets commonly prepared). Other than for the usual security registration requirements for Singapore-incorporated security providers, facility agreements for acquisition finance transactions are not required to be filed in Singapore where the target is Singapore-incorporated.

3.9 Recent Legal and Commercial Developments

See **1.5 Banking and Finance Techniques**.

3.10 Usury Laws

While the Moneylenders Act 2008 does impose maximum interest (ie, a nominal interest rate of 4% per month), banks and other excluded lenders are not subject to such restriction. Contractual provisions providing for the payment of additional or an increased rate of interest may not be recoverable if they amount to a penalty under Singapore law, and the Supreme Court Practice Directions generally provided that every judgment debt shall, unless otherwise agreed between the parties, carry interest at the rate of 5.33% per annum, or at such other rate as the Chief Justice may from time to time direct, or at such rate not exceeding that rate as the Singapore court directs. With respect to penalty considerations, an 18% default interest rate was held to be a penalty in Hong Leong Finance Ltd v Tan Gin Huay.

3.11 Disclosure Requirements

While there are no general rules for disclosure of all loan agreements, there may be requirements particular to specific entities. For example, borrowers which are subject to SGX Listing Rules are required to disclose details of conditions in loan agreements that refer to – eg, shareholding interests of any controlling shareholder, REIT manager or trustee-manager, or a restriction on any change in control of the borrower, REIT, REIT manager or trustee-manager, or on any change of the REIT manager or trustee-manager, as well as the level of facilities that may be affected by a breach of such condition.

4. Tax

4.1 Withholding Tax

Singapore does not generally subject payments of principal to withholding tax. Payments of (or in the nature of) interest or other payments in connection with the loan may be subject to withholding tax under the Income Tax Act 1947, depending on the relevant jurisdictions.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Security over shares and real property are generally subject to stamp duty of up to SGD500 in Singapore. Fees may be charged by government authorities for security registrations such as registrations with the Accounting and Corporate Regulatory Authority and the Singapore Land Authority; these fees are generally nominal.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Singapore-incorporated borrowers will need to consider – eg, withholding tax considerations and the applicability of double-taxation agreements, when borrowing outside Singapore from foreign lenders.

5. Guarantees and Security

5.1 Assets and Forms of Security

Real Estate

One of the most common assets taken as security in Singapore is real estate. Where separate title has been issued for real estate, a mortgage over such real estate can be taken as security in the form prescribed by the Singapore Land Authority. A real estate mortgage will need to be stamped for up to SGD500 in Singapore within 14 days of execution and delivered for registration to the Singapore Land Authority with the title documents in relation to that property and payment of a nominal registration fee to the Singapore Land Authority. Failure to have the document stamped renders it inadmissible in court, and late stamping is subject to financial penalties.

Shares

Share security over shares issued by a Singapore-incorporated company is also common. Customary deliverables and perfection steps differ depending on whether those shares are issued by a private or public Singapore-incorporated company and, in the latter case, may differ further depending on how those shares are held. Share security is subject to stamping of up to SGD500 in Singapore.

Floating Charges

Singapore also permits floating charges over all present and future assets of a Singapore-incorporated company; such security would commonly be taken by way of a general debenture. This would usually be drafted to cover all assets, including shares and real estate, and would similarly need to be stamped for up to SGD500 in Singapore.

Registration of Securities

Particulars of security created by a Singapore-incorporated company are generally registrable in Singapore with the Accounting and Corporate Regulatory Authority for a nominal fee of SGD60. The Companies Act 1967 prescribes categories of registrable security but these are generally very broad. Registration needs to be completed within 30 days of execution if executed in Singapore. Failure to register results in such security being void against the liquidator and creditors of that security provider.

Stamping and registration of particulars of security in Singapore are generally conducted through the online systems of the relevant government authority and are fairly instantaneous. As a matter of practice, however, parties generally buffer one to three business days to complete these, to account for contingencies and disruptions.

5.2 Floating Charges and/or Similar Security Interests

Singapore permits floating charges over all present and future assets of a Singapore-incorporated company.

5.3 Downstream, Upstream and Cross-Stream Guarantees

Subject to considerations of corporate benefit, particularly in the case of upstream and cross-stream guarantees, it is not unusual for lenders to take such guarantees. Other limitations include the financial assistance rules, mentioned in **3.4 Restrictions on the Borrower's Use of Proceeds**, in relation to provision of guarantees by a Singapore-incorporated public target or its subsidiaries supporting the acquisition of shares in itself or its subsidiaries; restrictions in the Companies Act 1967 on the giving of guarantees covering indebtedness of corporate entities not within the same group structure; as well as any restrictions imposed by a company's constitutive documents or private contracts. If guarantors are not within the same group structure (ie, they do not share the same holding company), parties will also need to consider whether the guarantee structure contravenes the Companies Act 1967 prohibitions on the granting of guarantees by a company to third parties that are connected with the directors of that company.

5.4 Restrictions on the Target

Financial assistance restrictions apply where the target is a Singapore-incorporated public company or subsidiary thereof. The Companies Act 1967 provides for several whitewash methods and exclusions. The most common whitewash methods include a long-form whitewash which takes at least a month in practice and involves public notifications; and one of the short-form whitewash methods which requires statutory solvency statements from the directors of the company providing financial assistance.

5.5 Other Restrictions

Other than the above, greater diligence is usually required for regulated security providers. Licence terms and legislation may prohibit or set conditions on the granting of security or guarantees. For example, the Securities and Futures (Licensing and Conduct of Business) Regulations set conditions on the creation of security by a capital markets services licence holder over its customer's assets. Housing developer licences may also contain restrictions over liabilities, which may be secured by a mortgage over the housing property to be developed. Where contracts and contractual proceeds are a key component of a security package, contractual restrictions against assignment and creation of security are critical. In such cases, diligence and the actions required to obtain consent where possible become significant (but not always insurmountable) hurdles in the feasibility assessment of such security.

5.6 Release of Typical Forms of Security

Singapore law-governed security is typically released by a deed of release or deed of discharge, save where security was taken in a prescribed statutory form (eg, a Singapore statutory mortgage), where local authorities may similarly prescribe statutory forms of release.

5.7 Rules Governing the Priority of Competing Security Interests

The rules of priority of competing security interests in Singapore are complex. Between the same type of registered security interests, the security interest created first in time generally has priority. This is then complicated by priority between different types of security interests; for example, a perfected legal assignment would

generally take priority over an unperfected equitable assignment, and floating charges rank behind fixed charges. Contractual subordination of claims is a common contractual structure adopted in Singapore law financings where senior creditors, subordinated creditors and the borrower enter into a contractual subordination deed setting out the relevant priorities.

5.8 Priming Liens

In an insolvency of a Singapore-incorporated company, the Insolvency, Restructuring and Dissolution Act 2018 provides for certain payments to be paid out in priority to unsecured debts. These are mandatory and generally include wages and salaries, retrenchment benefits, work injury compensation and tax.

The Insolvency, Restructuring and Dissolution Act 2018 also provides that the Singapore court may make an order for "rescue financing" for a company which has applied for a scheme of arrangement or in judicial management, to be accorded with super priority in a winding up or (where the company would not have been able to obtain the rescue financing from any person unless secured and there is adequate protection for the interests of the holders of existing security interest) with higher priority security. In the context of judicial management, a lender with security over the whole (or substantially the whole) of the company's property and which is, or may be, entitled to appoint a receiver and manager of such assets, may oppose the making of an order for judicial management, and if so opposed, the court must dismiss an application for such order.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Typically, Singapore law-governed security documents will provide that a secured lender can enforce its collateral upon the occurrence of a trigger event; this is usually either an "event of default" or an "acceleration event". Initial and usual enforcement remedies are primarily self-help (eg, letters of demand, appointments of private receivers where contractually provided) with court processes (eg, winding-up, injunctions, court-appointed receivers) also available to supplement such self-help remedies. Insolvency and restructuring-related processes could trigger moratoria on enforcement, and insolvency legislation also limits enforcement of certain contracts solely by virtue of insolvency (ie, restrictions on ipso facto clauses); these are further detailed in **7.1 Impact of Insolvency Processes**.

6.2 Foreign Law and Jurisdiction

The choice of foreign law to govern contracts is generally upheld by Singapore courts, but would not be recognised if the choice of law was not bona fide and legal, or if there were reasons for avoiding the choice of law on the grounds of public policy. Singapore has passed the Choice of Court Agreements Act 2016 to give effect to the Convention on Choice of Court Agreements. This provides a statutory framework for recognising and upholding exclusive choice of court agreements designating the courts of contracting states. Contractual waivers of immunity are frequently included in Singapore law-governed finance documents.

6.3 Foreign Court Judgments

The Choice of Court Agreements Act 2016 also provides the statutory framework for recognising

and enforcing judgments of the foreign courts of other similarly contracting states designated in exclusive choice of court agreements, subject to the exceptions in the Convention on Choice of Court Agreements. This is supplemented by prior legislation such as the Reciprocal Enforcement of Foreign Judgments Act 1959, which recognises certain foreign judgments from the specified foreign jurisdictions, which may not have been covered by the Choice of Court Agreements Act 2016. For international arbitral awards, the International Arbitration Act 1994 gives effect to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and provides that the relevant arbitral awards may be enforced and judgment entered with the permission of the court.

6.4 A Foreign Lender's Ability to Enforce Its Rights

There are generally no restrictions requiring a lender to be authorised or qualified to carry on business in Singapore solely to enforce its rights under a valid loan agreement or security agreement.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

The Insolvency, Restructuring and Dissolution Act 2018 provides for moratoria in certain insolvency-related situations (eg, if a Singapore-incorporated company is placed under judicial management and placed under a scheme of arrangement). Such moratoria would generally restrain proceedings and enforcement of security against that company. For a scheme of arrangement, an automatic worldwide moratorium applies for 30 days from the date that the relevant application is made.

The Insolvency, Restructuring and Dissolution Act 2018 also restricts the exercise and enforcement of ipso facto clauses in contracts which allow for termination, acceleration, etc, by reason of insolvency or commencement of insolvency proceedings. Certain specified contracts are excluded from the ambit of the restriction. However, there is no broad exclusion for all types of loan and security agreements.

7.2 Waterfall of Payments

Secured creditors are generally paid in order of priority to the extent of the security. Otherwise, when a Singapore-incorporated company is wound up, certain preferential debts must be paid before all other unsecured debts. Key preferential debts include:

- the costs and expenses of the winding-up incurred by the official receiver, and any other costs and expenses of the winding-up;
- all wages or salaries;
- all amounts due for work injury under the Work Injury Compensation Act 2019;
- other specified amounts due in relation to employees (eg, specified contributions under provident funds, remuneration payable for specified leave and retrenchment benefits); and
- the amount of all tax assessed and all goods and services tax due under any written law, before commencement of the winding-up or assessed at any time before expiration of the time fixed for the proving of debts.

7.3 Length of Insolvency Process and Recoveries

Schemes of Arrangement

The length of the process and recovery for creditors varies depending on the circumstances and specific terms of the particular scheme of arrangement.

Judicial Management

Judicial management typically lasts for 180 days from the date of the court order or creditors' meeting approving the appointment of a judicial manager. The judicial management can be extended by an application to court by the judicial manager or by the approval of a majority in number and value of the creditors. Recoveries to the creditors is highly dependent on the assets available to the debtor company and any proposed restructuring plan put forward by the judicial manager.

Liquidation

The length of the process and recovery for creditors varies depending on the circumstances (including time taken to realise assets and adjudicate proofs of debt) and the unencumbered assets available for distribution.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Rescue and reorganisation procedures in Singapore include the following.

Schemes of Arrangement

This is a statutory restructuring process whereby a company and its creditors seek to agree on a restructuring scheme to be court-sanctioned and eventually approved. The Insolvency, Restructuring and Dissolution Act 2018 introduced new features such as cram-down provisions to empower the court to approve schemes in certain cases, despite dissenting classes of creditors and pre-packaged restructuring plans, without the need to convene creditor meetings.

Judicial Management

This is a restructuring option similar to the English administration regime. Judicial management in Singapore is intended to rehabilitate a company where liquidation or winding-up would be less advantageous. The Insolvency, Restructuring and Dissolution Act 2018 introduced changes to allow foreign companies with a substantial connection to Singapore to apply for judicial management and also to limit a secured creditor's right to veto judicial management orders.

Both options feature statutory moratoria on debt enforcement in order to give the company breathing space while it proceeds with the reorganisation process.

The Insolvency, Restructuring and Dissolution Act 2018 also introduced the possibility for distressed companies to obtain fresh finance while undergoing reorganisation. A distressed company can make an application to the court for an order granting super-priority status to debts arising from the rescue financing; such orders could include the granting of priority over all other preferential debts, or allow the creation of a security interest over existing encumbered assets and the subordination of any existing security interests.

In this connection, the court has also approved the "roll-up" of a rescue lender's pre-existing debt into a super-priority debt. This is achieved through applying a portion of the rescue-financing proceeds towards repayment of the rescue lender's pre-existing debt.

7.5 Risk Areas for Lenders

As mentioned in **7.1 Impact of Insolvency Processes**, lenders need to tackle new considerations arising from the Insolvency, Restructuring and Dissolution Act 2018. These include the restriction on enforcement of ipso facto clauses. In certain cases, parent guarantee provisions have been bolstered in attempts to address such ipso facto restrictions and to ease and allow enforcement for parent companies falling

outside the scope of the restrictions. Additional considerations from the Insolvency, Restructuring and Dissolution Act 2018 include those mentioned above, such as new moratoria provisions (eg, the automatic 30-day worldwide moratorium for schemes of arrangement), and the introduction of cram-down provisions and priorities granted to rescue financings. Coupled with the ability of foreign companies (not just Singapore-incorporated companies) to seek restructurings in Singapore under the Insolvency, Restructuring and Dissolution Act 2018, where qualified, and the adoption of the UNCITRAL Model Law on Cross-Border Insolvency, it has becoming increasingly important, if not already absolutely crucial, for lenders to come to terms with the insolvency and restructuring regimes in Singapore.

8. Project Finance

8.1 Recent Project Finance Activity

Singapore project finance activity is primarily out-bound with both the public and private sectors actively working together to further cement Singapore's status as an infrastructure financing hub providing financial, advisory and other services across the entire value chain and from conception to financial close. Major industries benefiting from the expertise include renewables and transport. The depth of project finance activity has also led to multiple launches of project finance securitisations in Singapore.

Given Singapore's geographical footprint, where debt is required for domestic infrastructure projects in Singapore, these have been historically well-funded by banks or the public sector. The introduction of the Significant Infrastructure Government Loan Act 2021 further allows the Singapore government to borrow up to SGD90 billion to pay for qualifying infrastructure projects.

8.2 Public-Private Partnership Transactions

The three main sources of laws, regulations and guidelines for PPP transactions in Singapore are the Public Private Partnership Handbook, the Government Procurement Act 1997 and the Government Procurement Regulations 2014. With the introduction of the Significant Infrastructure Government Loan Act 2021, it remains to be seen what impact this will have on projects which may otherwise have been structured as a PPP, or whether the PPP model will continue primarily for specific projects such as existing use cases which have demonstrated success.

8.3 Governing Law

Project documents for domestic projects in Singapore are usually Singapore law-governed with disputes resolved in Singapore. In the case of project financings led out of Singapore for projects located in other jurisdictions, the general preference remains for the underlying project documents to be Singapore law-governed or English law-governed with disputes resolved in the relevant courts or an acceptable arbitral venue unless prohibited by local laws.

8.4 Foreign Ownership

Although foreign companies intending to conduct business in Singapore are required to be registered in Singapore and if so registered, may own real property in Singapore, given the ease and benefits of incorporation in Singapore, most (if not all) project companies for domestic infrastructure projects are incorporated in Singapore even where projects are awarded to consortiums comprising foreign investors.

8.5 Structuring Deals

A project company for a project in Singapore would typically be a Singapore-incorporated company incorporated under the Companies Act 1967. Restrictions may be imposed by the relevant project documents, and qualifications and restrictions would typically have been clarified as part of the tender process. Historical PPPs have included project companies formed by a consortium of local and foreign investors.

8.6 Common Financing Sources and Typical Structures

As mentioned in **8.1 Recent Project Finance Activity**, project financing lending in Singapore has largely been outbound, with lenders primarily being banks and multilaterals. Given Singapore's geographical size, where debt is required for domestic infrastructure projects, these have been historically well funded by banks or the public sector.

8.7 Natural Resources

Given Singapore's geographic characteristics, the extraction of natural resources is not a feature.

8.8 Environmental, Health and Safety Laws

The key regulator on broad environmental matters is the National Environment Agency, and on health and safety laws, the Ministry of Manpower. Projects might also involve other regulatory bodies depending on the type of project.

Generally, the following environmental, health and safety legislation would apply broadly to projects:

- the Environmental Protection and Management Act 1999;
- the Environmental Public Health Act 1987;
- the Sewerage and Drainage Act 1999; and
- the Workplace Safety and Health Act 2006.

Trends and Developments

Contributed by:
Susan Wong, Christy Lim and Felix Lee
WongPartnership LLP

WongPartnership LLP is headquartered in Singapore. WongPartnership is a market leader and one of the largest law firms in the country, offering its clients access to its offices in China and Myanmar, and in Abu Dhabi, Dubai, Indonesia, Malaysia, and the Philippines, through the member firms of WPG, a regional law network. Together, WPG offers the expertise of over 400 professionals to meet the needs of clients throughout the region. WongPartnership's expertise spans the full suite of legal services to include both advisory and transactional work where it has been involved in landmark corporate and financing transactions, as well as complex and high-profile litigation and arbitration matters. WongPartnership is also a member of the globally renowned World Law Group, one of the oldest and largest networks of leading law firms.

Authors

Susan Wong is head of the firm's financial services group and the banking & finance practice. She has extensive experience in local and international loan and other debt-related transactions including project, acquisition, real estate, investment and business trusts, asset and asset-backed and Islamic financing, syndicated and club loans, cross-border financing, risk and funded sub-participations, securitisations, sale of loans and receivables and security arrangements and documentation. She is an editorial board member of the Butterworths Journal of International Banking & Financial Law and a member of the Advisory Panel of the Centre for Banking & Finance Law at the Faculty of Law, National University of Singapore.

Christy Lim is the deputy head of the firm's banking & finance practice. Her main practice areas are banking, finance, security arrangement and documentation, syndicated loans, club deals, cross-border and multi-currency transactions, transferable loans, loans with embedded debt-instrument conversion options with a strong focus on acquisition/leveraged financing involving takeover offers, schemes of arrangement, delisting proposals/exit offers as well as mergers and acquisitions. Christy is a member of the Executive Committee, and Assistant Honorary Secretary, of the Financial Women's Association Singapore, and is also an adjunct instructor at the School of Law - Singapore Management University.

Felix Lee is a partner in the banking & finance practice. His main areas of practice include syndicated loans, club deals, bilateral loans, acquisition financing, green/sustainable financing, subscription financing, property financing, project financing, cross-border transactions and security arrangements and documentation. He has also advised on standard forms for consumer credit transactions and debt restructuring. He has acted for banks, PE funds and corporate clients in notable cross-border and domestic acquisition financings.

WongPartnership LLP

12 Marina Boulevard
Level 28 Marina Bay Financial Centre
Tower 3
Singapore
018982

Tel: +65 6416 8000
Fax: +65 6532 5711 / 5722
Email: contactus@wongpartnership.com
Web: www.wongpartnership.com

Contributed by: Susan Wong, Christy Lim and Felix Lee, WongPartnership LLP

Introduction

Soaring inflation, rising interest rates and global supply chain disruption owing to geopolitical tensions saw Singapore's GDP growth numbers halved from 7.6% in 2021 to 3.8% in 2022. The outlook for Singapore in 2023 is expected to remain challenging as Singapore's economy narrowly avoided a recession in the second quarter of 2023, and growth forecasts for 2023 have been trimmed on the back of weak global demand.

The uncertain climate has driven Singapore companies to implement a variety of cost-cutting measures as they look to slow down or put expansion plans on hold and move to stabilise their balance sheets.

The increased borrowing costs resulting from the high interest rate environment have led to borrowers facing challenges in servicing existing loans and being more cautious in taking on new loans, culminating in a contraction in business lending in Singapore by 0.8% in 2022.

The move to risk-free rates as the new benchmark interest rate in the context of Singapore financings (which saw many borrowers in Singapore amending their existing facilities over the span of a lengthy transition period to cater for the introduction of these risk-free rates) has largely been completed, with the Singapore Dollar Swap Offer Rate (SOR), the USD London Interbank Offered Rate (USD LIBOR), and the London Interbank Offered Rate (USD LIBOR) being discontinued earlier in 2023.

Other notable trends and developments in the Singapore financing scene include a general slowdown in the real estate as well as acquisition financing sectors, the increased prevalence of green and sustainability-linked loans, the emergence of transition financing, growing interest in peer-to-peer lending, and the anticipation of an increase in the popularity of Islamic financing in the near future. These trends and developments and others are discussed in more detail below.

Real Estate and Development Financing

Activity in Singapore's development financing sector remains slow, given the state of Singapore's property market. While the market saw some positive developments in the first quarter of 2023, particularly for commercial property sales, the last few months have demonstrated that full recovery in this sector may be some time away (in the second quarter of 2023, real estate investment volume totalled SGD3.495 billion, which was a fall from the SGD6.068 billion invested in the first quarter of 2023. In comparison, the first half of 2022 saw SGD19.193 billion in such investments).

This cautious sentiment has its roots in global macroeconomic factors. Interest rate volatility has made loan financing less attractive to investors, prompting them to adopt a warier approach in the hope that interest rates may stabilise later in 2023. In particular, the collective sale market has been affected by the high interest rate environment, with only five successful collective sales in 2023 (a collective sale involves the sale of multiple property units to a common buyer, and requires consent exceeding a stipulated threshold from existing owners). For private residential collective sales, homeowners have generally been unwilling to price their developments lower given the high replacement costs that they face, with developers being unwilling to match the prices due to the costs of financing. The convergence of these two factors has resulted in the ongoing deadlock between developers and homeowners over collective sale prices. Until interest rates stabilise, more cautious develop-

ers may delay investing in projects within the residential real estate market, tempering the demand for development financing.

Despite relative instability in the macroeconomic environment and the general slowdown in the financing sector, development financing is still sought by developers in relation to industrial real estate. With industrial property in tight supply, this presents an opportunity for developers to meet demand by acquiring land launched through the Ministry of Trade and Industry's Industrial Government Land Sales Programme. The participation of such developers in land sales may well provide a boost to development financing in the second half of 2023, when land zoned for industrial activity is put up for bidding.

Green Loans and Sustainability-linked Loans

Green loans and sustainability-linked loans (SLLs) have seen a surge in popularity over the past few years as greater emphasis continues to be placed on the accountability of businesses and corporate actors for environmental, social and governance (ESG) issues (with global credit-rating agencies beginning to differentiate credits based on ESG attributes). The adoption rate of SLLs for development financing in particular has been healthy, with companies and REITs in the real estate sector accounting for 46% of green or sustainability-linked debt in 2021.

Green loans

Green loans remain highly relevant in the market, with Singapore companies borrowing up to USD39.5 billion in green loans as at the end of 2022.

In Singapore, green loans feature prominently in property and development financings owing to a confluence of factors such as the presence of a robust certification scheme for green buildings and the Singapore Green Building Masterplan, under which the nationwide target is for 80% of buildings to be certified green or to have best-in-class energy efficiency by 2030. There has also been an increase in government incentives in the Asia-Pacific region for property developers to focus on sustainable developments, which may be attributable to the growing awareness of the vulnerability of urban areas to climate issues.

Prominent green property financing transactions in Singapore include the largest syndicated green loan financing in Asia as at the date of completion – an SGD3 billion financing of the mixed-use project development at 8 Shenton Way (slated for completion in 2028), which will become Singapore's first supertall building (ie, over 300 metres in height) when completed, redefining the landscape of Singapore.

Sustainability-linked loans

SLLs have seen an increase in popularity across various sectors in Singapore, including real estate and project financing. In the real estate sector alone, SLLs and ESG-linked loans totalled SGD75 billion in 2021.

Growth in these sectors is in a large part attributable to the Singapore government's creation of a regulatory framework within which issuers and borrowers of SLLs can work, particularly in relation to ESG reporting.

The government has also provided numerous incentives to buttress the attractiveness of green loans and SLLs, such as the launch of the Green and Sustainability-Linked Loan Grant Scheme (GSLS) in 2020 by the Monetary Authority of Singapore (MAS) to reduce costs for engaging sustainability advisers and co-funding the development of SLL frameworks for small and medium enterprises (SMEs) and individuals. As at the

date of this article, the MAS has announced that it will be injecting an additional SGD15 million to increase and enhance the scheme (which will be expanded to include transition bonds and loans) and be extended up to 31 December 2028.

SLLs are also popular with borrowers because of the sustainability margin adjustment mechanism that is a fundamental feature of SLLs (upon satisfying pre-designated Sustainability Performance Targets, borrowers are able to enjoy reduced margins which will, in turn, reduce their funding costs).

Another key factor is the support of Singapore's major banks, with DBS Bank Ltd., Oversea-Chinese Banking Corporation Limited and United Overseas Bank Limited planning to avail between SGD30 billion to SGD50 billion each in SLLs by 2024. Each of these banks has exceeded their initial SLL projections. Noteworthy financings include the grant of an SGD1.2 billion SLL to Sembcorp Financial Services Pte. Ltd. by a group of banks including DBS Bank Ltd. and Oversea-Chinese Banking Corporation Limited for, amongst others, the financing or refinancing of renewable energy and other sustainable projects. United Overseas Bank Limited has also recently granted a TWD1 billion (SGD42 million) SLL to CHIMEI Corporation, which specialises in producing a variety of high-tech synthetic rubbers, specialty chemicals and performance materials including those covered by EcologueTM. Such loans are indicative of a shift from traditional non-sustainability-linked loans towards SLLs.

Project Finance – Transition Finance

With the Singapore government's commitment to achieving net zero emissions by 2050, it has been recognised that green loans and SLLs, whilst important, are, on their own, insufficient to achieve this goal. Borrowers in high-emitting sectors, such as aviation and energy generation, in particular, would find it challenging to take up green loans and SLLs given the nature of their industries. This has led to the emergence of "transition finance", which generally refers to the investment, lending, insurance and the provision of other related services to gradually decarbonise high-emitting industries such as power generation, buildings and transportation.

At the end of the first half of 2022, 53 transition use-of-proceeds bonds have been issued, with issuance mainly coming from issuers based in Japan and China due to the efforts made by the regulators in those countries to spur transition financing.

The MAS has recently updated and expanded the Green Finance Action Plan, which was introduced in 2019. The refreshed plan is titled Finance for Net Zero Action Plan ("FiNZ Action Plan") and its scope is widened to not only cover green financing but also transition financing. The FiNZ Action Plan envisages four strategic outcomes, as outlined below.

More reliable and comparable climate and sustainability data

First, MAS plans to ensure that climate and sustainability data are more reliable and comparable to allow financial market participants to be able to better assess their exposure to ESG risks and opportunities. On a cross-border level, MAS also seeks to provide clarity on the nomenclature used in the industry to facilitate effective communication and data comparison, which will, in turn, facilitate transition financing flows across jurisdictions. For example, MAS states that a code of conduct is currently in the pipeline. Working hand-in-hand with the industry, the code will require ESG rating agencies and data

product providers to disclose how transition risks are accounted for in their products. The greater transparency from the aforementioned measures will help to alleviate greenwashing concerns.

Climate and environmental risk management practices

Second, MAS will reach out to financial institutions to build good climate and environmental risk management practices. More specifically, and more pertinently for our purposes, MAS will supervise the financial institutions' response to climate risks and their transition to operating in a low-carbon business environment.

Transition plans

Third, MAS will promulgate the implementation of credible transition plans by financial institutions. Such a plan is one that not only manages the financial institution's own risks but also contributes towards the decarbonisation of the wider economy. In addition, financial institutions are encouraged to engage with their clients on the measures that they can take to decarbonise their businesses and take reference from sectoral decarbonisation pathways when doing so.

Grant schemes

Fourth, as MAS' existing grant schemes for sustainable bonds and loans proved to be popular (as more than SGD30 billion worth of sustainable debt was issued last year), MAS will be improving on and extending the duration of the schemes to cover transition bonds and loans. So, a company that is obtaining a transition loan with a tenure of at least three years and a loan quantum of at least SGD20 million (or equivalent in another currency) is eligible for a grant of up to SGD125,000 to defray the costs incurred in engaging independent service providers to validate the sustainability credentials of the loan.

Given that Singapore targets to convert 80% of its buildings from "brown" to "green" by 2023 (of which 55% has been completed) and that about 95% of Singapore's electricity is still being generated from natural gas, transition financing is likely to feature prominently in Singapore in the coming years.

Peer-to-peer Lending

While much focus has been placed on how technological advances are streamlining and improving traditional bank lending, it is also worth noting the role of technology in disrupting traditional bank lending. In recent years, alternative lending, for example peer-to-peer (P2P) lending, has seen growing prevalence in the form of digital platforms directly connecting lenders and borrowers. P2P lending involves directly matching borrowers seeking shorter-term financing, which are often SMEs (SMEs may not be able to procure bank financing as they may not have adequate credit standing or collateral to provide), and lenders, which may be institutional or retail investors, through online platforms that also facilitate the collection, evaluation and transmission of the borrower's details to these potential lenders.

The ability of SMEs to obtain financing continues to pale in comparison to that of more established borrowers in the market, with the financing needs of SMEs for operations or development far outstripping their access to such financing. This creates a funding gap for SMEs in Singapore which is estimated to be approximately USD20 billion a year. This gap has allowed P2P platforms to engage SMEs looking for a more expedient borrowing process and less stringent requirements. The digital nature of the P2P financing process greatly streamlines loan applications and approval processes. The types of loans disbursed also vary from product to prod-

uct and can come with flexible terms depending on the lender. From the lenders' perspective, a big draw is higher interest rates (albeit that this may come with a higher default risk, and a relative lack or absence of security or other credit support).

Several prominent home-grown names in the field include Validus Capital and Funding Societies. Validus, which received contributions totalling USD35 million within five years of its inception from prominent investors such as Temasek-affiliated Vertex Ventures, had disbursed loan amounts totalling over SGD550 million in the same period. Validus has partnered with corporates to enhance the data analytics processes that support the credit assessments of borrowers, eschewing the reliance on traditional financial indicators, which allows them to lend in more volatile sectors that banks typically avoid. Meanwhile, Funding Societies has lent more than SGD3.37 billion across Singapore, Indonesia, Malaysia and Thailand, accounting for one of the largest regional shares in the SME digital financing industry. As a testament to the standing of such P2P platforms, both Validus and Financing Societies have even been approved to disburse government-backed loans under the Enterprise Financing Scheme (helmed by Enterprise Singapore) (EFS), which was crucial in bridging the SME funding gap during the height of the COVID-19 pandemic.

By virtue of their lean operational costs and less stringent credit requirements, P2P lenders tend to benefit from increased popularity when global or regional factors trigger a reduction in credit supply from traditional banks. Interestingly however, Funding Societies noted an increase in traditional banks' lending share on their platform in 2020 while there was a drop in lending share for alternative lenders in the same period, which the platform attributes to increased governmental support for SMEs through the EFS during that period. This shows that the growing role of P2P lenders in the market in relation to traditional banks is not always a given.

Islamic Finance

Islamic financing is on the rise worldwide, with such increase in demand expected to feature more prominently in Southeast Asia, one of the largest markets for Islamic financial services.

A specific area of Islamic finance expected to see major growth is Islamic bonds or Sukuks, which are a form of Sharia-compliant financial product that seeks to mirror the coupon payments in bonds. Indeed, it is estimated that a total of USD21.6 billion was raised from Sukuk issuances in Southeast Asia from July 2021 to June 2022. Riding on the greater demand for ESG financial products, ESG Sukuks, in particular, are projected to almost double from making up 2.6% of the global Sukuk market today, to making up 5% of the global Sukuk market in the next five years.

The general consensus in the market is that Singapore is well-positioned to become a global hub for offshore Islamic wealth in the next five years as Singapore is recognised for its premier financial status in Asia-Pacific and its mature business environment, which is able to provide the secondary professional expertise and support required. This is bolstered by MAS' recent update on the guideline relating to the application of banking regulations to Islamic banking in Singapore issued on 1 July 2022. The updated guideline lays out MAS' general approach in relation to the regulation of Islamic banking, the admission framework for financial institutions seeking to offer Islamic financial services and

the regulatory treatment for Islamic banking products.

Acquisition Financing

While there has been an overall decline in mergers and acquisitions (M&A) activity in 2022, there remains some optimism that there will be at least a 20% increase in incoming cross-border M&A activity in 2023. In addition, there have been several noteworthy developments in this space, such as the following.

Enterprise Financing Scheme, M&A loans

The EFS was rolled out at the end of 2019 by Enterprise Singapore to provide newly-formed SMEs the option to make simplified applications with certain participating financial institutions in order to obtain various types of loans. Among such loan schemes, the EFS – Mergers & Acquisitions loan scheme (the "EFS M&A Scheme") is particularly popular, as it allows local SMEs to tap into funding for international M&A transactions that they would otherwise be precluded from obtaining. Participating lenders are also partially indemnified against the risk of borrowers' default, with Enterprise Singapore taking on a 50% risk share (with those meeting certain conditions enjoying a risk share by Enterprise Singapore of up to 70%). The EFS M&A Scheme has since been extended until March 2026 and expanded to include funding for domestic M&A activities. This is indicative of the government's ongoing commitment to supporting growth in the M&A sector, particularly in light of other EFS loan schemes either being discontinued or not being extended.

Covenant-lite loans

Covenant-lite loans are characterised by the paring down or absence of financial or maintenance covenants, such as covenants obliging borrowers to maintain a certain amount of assets or to ensure that their aggregate leverage does not exceed a pre-designated limit. The absence or paring down of such financial or maintenance covenants allows borrowers to focus on other aspects of the loan, particularly value creation. However, in the Asia-Pacific region (including Singapore), banks have thus far shown a preference for stronger covenants, and covenant-lite loans remain uncommon. Instead, other flexible loan structures with covenant-lite features such as Term Loan B (also referred to as institutional term loans or TLB) are more commonly adopted.

Special purpose acquisition companies

Special purpose acquisition companies (SPACs), as publicly listed companies with no business operations, serve as a medium through which investors can look to acquire and list target companies. In the US, SPACs have been immensely popular, with consistent growth in funds raised since 2003, and having raised capital in 613 IPOs and USD160 billion in 2021 alone. In comparison, Singapore only started introducing SPACs (and putting in place SPAC listing regimes) in the latter part of 2021. The relatively late arrival of SPACs together with strict SPAC listing regulations in Singapore (such as a minimum market capitalisation threshold of USD110 million which is significantly higher than the US' requirement of USD50 million to 100 million), appear to have resulted in the fairly low take-up rate of SPACs in Singapore. Since the listing of the first three SGX-listed SPACs early last year, there have been no new SPACs listed in Singapore. These three SPACs are in the midst of identifying targets to acquire (the "de-SPAC" process), and should these SPACs be successful in meeting their deadlines to de-SPAC by 26 January 2024, the SPAC market may yet receive a second wind.

For further details on the matters discussed in this section, please refer to the Trends and

Developments section of the Chambers Global Practice Guide for Acquisition Finance 2023 (Singapore).

Conclusion

While it appears that there will be lingering uncertainty over the global economic outlook at least for the rest of the year, one may expect with reasonable certainty that the Singapore market will be looking to respond and future-proof itself in the face of such challenges. The trends and developments explored above reveal an industry willing to tackle new challenges through industry-wide initiatives. They also spotlight the growing importance of ESG and sustainability, and the introduction of novel concepts to the lending sphere, such as the greater integration of alternative lending platforms and the increased access to funding for SMEs via P2P platforms. Indeed, set against a backdrop of slowing economies in Southeast Asia, Singapore's three local banks (ie, DBS Bank Ltd., Oversea-Chinese Banking Corporation Limited and United Overseas Bank Limited) posted decade-high profit margins as at the end of 2022, providing some optimism that the Singapore economy will remain resilient and adaptive going into the second half of 2023.

SWEDEN

Law and Practice

Contributed by:
Niklas Sinander, Emily Dahlqvist, Gustav Sälgström and Björn Wendleby
Harvest Advokatbyrå

Contents

Harvest Advokatbyrå was established in 2016 and is Scandinavia's largest independent specialist law firm with a clear focus on advising financial institutions. Its 20-lawyer strong banking and finance team advises clients ranging from innovative start-ups, payment institutions, banks, fund managers and credit providers, to crypto-asset service providers and other companies active in the Swedish financial sector. It advises on a wide range of legal and financial regulatory issues important for the finance industry, including compliance, internal audits, application procedures, AML/CTF, sustainable finance, as well as on outsourcing of technology services by financial institutions. The firm maintains continual and close contact with the Swedish Financial Supervisory Authority (Finansinspektionen, SFSA) and a number of its employees are SFSA alumni. The scope of its services also includes advising players from the banking and finance sector on corporate matters, such as setting up companies, transactional assistance, preparing and negotiating agreements, etc. It also assists with data privacy and data protection issues.

Authors

Niklas Sinander is a counsel at Harvest Advokatbyrå and has been working with financial regulatory compliance matters as well as banking and finance since 2013. Niklas provides legal and strategic advice to Swedish and international investors as well as regulated entities in all financial regulatory areas. His expertise in financial regulation primarily covers the areas of payment services, consumer credits, securities, asset management (UCITS and AIFMD), investment services (MiFID) and crypto-assets, where he advises on a broad range of matters. His expertise in banking and finance includes advising Swedish and international lenders and borrowers on structured finance such as acquisition finance, project finance and real estate finance.

Emily Dahlqvist is a senior associate at Harvest Advokatbyrå and is a member of the Swedish Bar Association. She has more than five years of experience working with financial regulatory matters. She specialises in financial regulation, especially in the areas of capital markets transactions, securities, asset management, investment services (MiFID 2), crowdfunding, payment services and AML. In her daily work, Emily advises clients in the financial industry, ranging from starts-ups to established institutions, such as investment firms, fund managers, issuers and payment institutions in matters relating to regulatory compliance, complex assessment issues, and raising capital. She also participates in projects with applications for authorisation with the SFSA.

Gustav Sälgström is a partner at, and one of the founders of, Harvest Advokatbyrå. His work is mainly within the area of regulatory issues, especially in the field of securities and fund operations, as well as AML. He has been active within the above-mentioned field since 2008 and has advised both fund and asset management companies on various legal matters and on their contacts with the SFSA. In his daily work, Gustav advises on a wide range of matters relating to authorisations with the SFSA and on various implementation projects, as well as corporate and contract law matters. He has participated in a number of projects implementing new legislation, such as MiFID 2, AIFMD and AMLD 4. His work experience also includes advising banks and borrowers in connection with financing.

Björn Wendleby is a partner at, and one of the founders of, Harvest Advokatbyrå. He is specialised in widely defined banking and finance matters, mainly within financial legislation, financing projects, sustainable finance, sustainability regulation and AML, as well as asset management. Björn has significant regulatory experience representing clients in contacts with the SFSA. In his daily work, he advises on a variety of matters relating to authorisations with the SFSA and on various implementation projects. Over the years, he has participated in several long-term projects implementing new legislation, such as MiFID/MiFID 2, PSD/PSD 2, AIFMD and AMLD 4.

Harvest Advokatbyrå AB

Engelbrektsplan 1
Box 7225
103 89
Stockholm
Sweden

Tel: +46 8 20 40 11
Email: info@harvestadvokat.se
Web: www.harvestadvokat.se

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Recent Economic Cycles

The recent economic cycles have affected the loan market in Sweden to a large extent. As the Swedish economy has been pushed into an ongoing recession since 2022, both banks and other lenders have taken a more careful approach towards borrowers in general. The high-yield bond market, as well as the leverage loan market, have slowed down due to increasing inflation, the Ukraine war and economic volatility. Many borrowers struggle to meet their financial covenants, which has resulted in work outs and restructurings. Leveraged borrowers tend to seek alternative financing sources when refinancing in light of the more careful approach from lenders. Also, an even weaker Swedish currency (SEK) tends to affect borrowers relying on import, but may in turn benefit borrowers exporting products and services.

Regulatory Environment

As regards the regulatory environment in Sweden, there has been no substantial changes in the legislation regarding credit institutions and similar during the last few years.

It should however be noted that Regulation (EU) 2020/1503 of the European parliament and the council of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937 requires crowdfunding providers to be licensed on 10 November 2023 at the latest. Crowdfunding was previously regulated under other Swedish legislation, and the crowdfunding regulation has brought a stricter regulatory environment for such actors and aims to strengthen investor protection. In a time where many borrowers need to turn to alternative financing sources, such investor protection legislation is much needed.

The Swedish Financial Supervisory Authority (SFSA) has communicated that its focus areas during 2023 are:

- continued consumer protection in light of (i) consumer credit institutions offering vulnerable consumers emergency loans and (ii) an increasing number of investments schemes;
- resilience to cyber-attacks and similar in the banking and insurance sector given the importance for the financial system of these sectors;
- greenwashing in the financial sector;
- compliance with anti-money laundering and counter terrorist financing rules in respect of payment service providers; and
- compliance with sanctions.

1.2 Impact of the Ukraine War

The Ukraine war has, as one of many factors, affected the Swedish economy and by extension also the loan market in Sweden. As commodities are unavailable, transports are hindered, the number of sanctions imposed on Russia and Belarus have increased, and other similar impacts, the prices for such commodities rise to levels that many companies and citizens cannot afford. As a result, both banks and other lenders have taken a more careful approach towards borrowers that are affected by such price fluctuations and that may default. As a result, high-risk projects tend to have difficulties raising loan financing.

After many years of covenant-light loan financings with low interest rates and borrower-friendly terms and conditions, lenders now apply stricter covenants and higher pricing of loans.

Further, and as previously mentioned, as the Swedish economy has been pushed into recession, both banks and other lenders have taken a more careful approach towards borrowers in general.

1.3 The High-Yield Market

Sweden, with its many fintech starts-ups and real estate companies, has over the past years been an attractive market for investors. As the Swedish economy has been pushed into recession, both banks and other lenders have taken a more careful approach towards borrowers in general. The Swedish bond market generally offers borrowers less strict and more flexible covenants compared to traditional bank loan financing. Given uncertainties on the financial markets since the Ukraine war, issuers tend to raise smaller-sized debt on the bond market. The high-yield market has weakened due to economic volatility which, in turn, has forced borrowers into seeking alternative sources of financing.

Flexibility to reallocate amounts (structural flexibility) between different tranches in multi-tranche facility deals have been used more frequently to facilitate syndication processes.

1.4 Alternative Credit Providers

For some years, alternative credit providers have offered borrowers an alternative to traditional bank loan financing and bond financing. Such alternative credit providers may be direct lenders, crowdfunding and peer-to-peer lenders. Alternative credit providers may offer borrowers faster funding and more flexible terms and conditions than on the traditional loan market.

1.5 Banking and Finance Techniques

The portion of loans provided by alternative lenders on the Swedish market continues to increase. Credit funds, direct lenders and peer-to-peer lenders offer alternative financing, particularly for small and medium-sized companies, to traditional bank loan financing and bond financing. The Swedish fintech sector has for some years grown significantly, resulting in new players offering more flexible financing. Other direct lenders, not least institutional investors, also offer an alternative to traditional bank loans for borrowers on the corporate market.

1.6 ESG/Sustainability-Linked Lending

The sustainability trend on the Swedish loan market continues to increase, resulting in more corporate borrowers entering into sustainability linked loans with traditional banks. Key performance indicators in sustainability linked loans continue to further develop market standards.

In addition to that, the boom of green projects, in particular onshore wind power projects, raising green loans on the Swedish market has, compared to many other industries, continued its growth despite more volatile world economics.

2. Authorisation

2.1 Providing Financing to a Company

Providing loan financing to Swedish companies is not itself subject to a licence. However, such services may generally fall within the scope of the Swedish Currency Exchange and Other Financial Activities Act, provided that such services are provided on a professional basis and are deemed to be the main part (taking into account certain other regulated activities) of the business of that entity. If so, the provision of such loan financing generally requires a registration with the SFSA.

Generally, banking business and financing business are heavily regulated in Sweden and fall

within the scope of the Swedish Banking and Financing Business Act. In short, banking services include (i) processing payments via general payment systems and (ii) receiving funds that are repayable to the creditor within 30 days of notice. Generally, financing businesses include (i) accepting repayable funds from the public and (ii) granting loans, providing guarantees or conducting certain leasing (acquiring claims) activities.

There are generally only a few alternatives for entities to provide financing to a Swedish company, provided that such services are deemed to fall within the scope of licensable activity (ie, a registration pursuant to the Swedish Currency Exchange and Other Financial Activities Act is not sufficient).

Foreign Credit Institutions

Foreign credit institutions holding a licence in another EEA country may submit a passporting notification to the competent authority in that entity's home member state, to provide its regulated banking services to another EEA country (including Sweden). The competent authority will review the notification and notify the SFSA that such entity will provide services in Sweden. Such entity will thereafter be permitted to provide its regulated banking services on a cross-border basis into Sweden from its home member state.

Foreign credit institutions holding a licence in another EEA country may, instead of providing its banking services on a cross-border basis, submit a notification to the competent authority in its home member state to establish a branch or representation office in Sweden. Such notification shall, among others, include a business plan.

Non-authorised Entities and Third-Country Credit Institutions

Entities not holding a credit institution licence in another EEA country need to apply for a licence with the SFSA in order to conduct banking or financing business in Sweden. The details of the application requirements will be different depending on the relevant licence and the extent of such licence. However, the following items are typically included:

- detailed business plan describing inter alia the business, the organisation, the services, any outsourcing arrangements, ownership structure, etc;
- policies regarding inter alia credits, internal governance, risk management, remuneration, business continuity, etc;
- financial projections for the next three years;
- ownership and owner executive assessments; and
- management assessments.

Credit institutions based outside the EEA may, in order to provide their banking or financing business in Sweden, submit an application with the SFSA to establish a branch in Sweden.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Foreign lenders are generally not restricted from providing loans to Swedish companies. However, foreign lenders providing loans in Sweden may require a registration with, or licence to be granted by, the SFSA (see **2.1 Providing Financing to a Company**).

Further, some countries are considered as "high-risk third countries" from an AML perspective,

which can impede or even forbid such business to be operated. The same applies to foreign lenders that fall within the scope of sanctions.

3.2 Restrictions on Foreign Lenders Receiving Security

Foreign lenders are not restricted or impeded from receiving security or guarantees.

3.3 Restrictions and Controls on Foreign Currency Exchange

Foreign currency exchange controls are not imposed in Sweden and there are generally no restrictions in this regard on commercial transactions.

It may be noted that there is a reporting requirement in respect of certain financial institutions covering certain cross-border payments. Such reporting should be made to the Central Bank of Sweden (*Riksbanken*).

3.4 Restrictions on the Borrower's Use of Proceeds

There are no general restrictions under Swedish law on the borrower's use of proceeds from loans or debt securities, but there are specific restrictions in relation to, for example, financial assistance (see **5.3 Downstream, Upstream and Cross-Stream Guarantees**) and transactions not permitted by AML rules and sanction rules.

Further, it should be noted that the use of proceeds is typically regulated in the loan agreement between the lender and the borrower.

3.5 Agent and Trust Concepts

Agents

The concept of agents is recognised in Sweden and is commonly used in structured financing transactions.

Trusts

The concept of trusts is not recognised in Sweden.

3.6 Loan Transfer Mechanisms

Lenders may generally transfer loans, together with the existing security package, to a third party. Strong borrowers, most commonly investment-grade companies or borrowers backed by private equity sponsors, may successfully negotiate to limit loan transfers to a certain group of pre-approved lenders or financial market participants regularly engaged in lending business on the Swedish market.

The relevant security package should be transferred in connection with the loan transfer since Swedish law requires that there is an existing or future debt in order for the security interest in relation thereto to be valid. Due perfection of the security package should be taken into consideration in connection with a transfer of the loan and the security package to a new lender.

3.7 Debt Buy-Back

Swedish law does not restrict debt buy-backs, but Swedish law-governed facilities agreements generally contain standard LMA-based restrictions in relation to this. Debt buy-backs are not common on the Swedish loan market given that most loan deals on the Swedish market are syndicated loans, with low activity on the secondary market.

3.8 Public Acquisition Finance

Before an offeror makes a tender offer (public takeover bid) in respect of a Swedish company whose shares are listed on a Swedish stock exchange, the offeror must have secured funding to complete its tender offer. A tender offer should, among others, include a description of the financing arrangement, meaning that

the offeror needs to describe any third-party financing (including conditions for such financing arrangement).

Certain fund provisions are not only used in the context of public acquisition finance – the use of these provisions is quite common in relation to private equity transactions.

3.9 Recent Legal and Commercial Developments

The increasing number of sanctions imposed on Russia, Belarus and entities established and/or connected thereto, have caused changes in legal documentation in relation to borrowers with some kind of Russian or Belarusian connection. Lenders tend to be even stricter and pay more attention to sanction provisions as a result of the Ukraine war.

3.10 Usury Laws

Usury is considered a criminal offence under the Swedish Criminal Act (*Brottsbalken*).

Where a person exploits someone else (eg, due to distress, lack of understanding, or similar) when entering into an agreement or some other action with legal consequences with the purpose of benefiting therefrom, and the benefit is clearly disproportionate to the consideration, or for which no consideration is to be paid, it is considered usury.

Further, where a person who, when providing credit in business activities or other activities conducted habitually or otherwise on a large scale, obtains interest or some other financial benefit that is clearly disproportionate to the consideration, it is also considered usury.

There are in respect of commercial transactions no clear limits on what interest rates would be considered usury. Such limits are therefore determined on a case-by-case basis.

It may also be noted that an interest rate provision can be modified or set aside if considered to be unfair or unreasonable pursuant to the Swedish Contracts Act. However, the threshold for a contractual provision to be considered unfair or unreasonable in a commercial relationship is rather high.

Further, there is an interest rate cap, calculated as the reference rate plus 40%, in respect of certain high-cost credits provided to consumers pursuant to the Swedish Consumer Credit Act. Such high-cost credits (excluding certain credit purchases and housing loans) generally relate to consumer consumption.

3.11 Disclosure Requirements

There is no specific Swedish regulation regarding disclosure of certain financial contracts.

4. Tax

4.1 Withholding Tax

Payments of principal or interest to foreign lenders are generally not subject to withholding tax under Swedish law, provided that such lenders are entities not organised under Swedish law and that do not conduct business activities from a Swedish permanent establishment.

4.2 Other Taxes, Duties, Charges or Tax Considerations

There are no other specific major restrictions, consents required to approve, or significant costs associated with granting security or guarantees under Swedish law. However, the issuance of new business mortgage certificates and property mortgage certificates will require

a stamp duty to be paid in connection with the issuance. Such stamp duty is a one-time cost and such certificates may, after issuance, be reused without additional stamp duty to be paid.

Business Mortgage Certificates

The stamp duty for the issuance of a new business mortgage certificate currently amounts to 1% of the face value of the business mortgage certificate.

Property Mortgage Certificates

The stamp duty for the issuance of a new property mortgage certificate currently amounts to 2% of the face value of the business mortgage certificate.

Other Assets

Security over ships and aircraft are also subject to stamp duty.

Fees

Minor application fees will be payable in addition to the payments of stamp duty as described above.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Foreign lenders, being entities not organised under Swedish law and that do not conduct business activities from a Swedish permanent establishment, are generally not subject to Swedish income tax in respect of payments of principal amounts or interest of loans. However, lenders based in Sweden may be subject to taxation in respect of income that derive from certain capital assets, such as interest. Foreign lenders, including non-money centre bank lenders, should therefore carefully consider their operations and potential permanent establishment in Sweden to have visibility on their situation from a Swedish law tax perspective.

5. Guarantees and Security

5.1 Assets and Forms of Security

Under Swedish law, a security interest can generally be created over any asset. The most common types of assets that security is created over are shares, real property, cash deposited in bank accounts, receivables and business mortgages.

A binding agreement between the pledgor and the pledgee is required under Swedish law to create a security interest. Such security agreement may be made in oral form or, as is the case in almost all commercial transactions, written form.

Due perfection of the most commonly used assets that security is created over are made as follows.

Shares

Security can be taken over shares in a limited liability company and such security interest is commonly created by way of a pledge. Perfection of the security interest created over the shares, represented by physical share certificates issued by that company, requires that the physical share certificates representing the pledged shares are handed over to the pledgee.

In relation to companies whose shares are electronically registered with the Central Securities Depository, perfection of the security interest is made by way of:

- registration if the shares are held in the owner's name; and
- notice to the relevant custodian if the shares are being held by a custodian.

Real Property

Security over real property is created by way of pledging mortgage certificates representing a certain sum and a certain ranking in relation to the real property.

Perfection of a pledge of physical mortgage certificates is made by way of handing over the physical mortgage certificates to the pledgee. In relation to a pledge over electronic mortgage certificates, perfection is made by way of registration with the Swedish Land Registration Authority (*Lantmäteriet*).

Business Mortgage (Floating Charge)

Security can be taken over business mortgages (floating charges) covering certain moveable property, such as inventory, claims and similar, of the security provider. A business mortgage does not include cash, proceeds on bank accounts, financial instruments and similar. Business mortgage certificates will represent a certain sum and ranking in relation to business mortgages in respect of a company.

Security over physical business mortgages is perfected by way of handing over the physical business mortgage certificates to the pledgee. Security over electronic business mortgage certificates is perfected by way of registration with the Swedish Companies Registration Office (*Bolagsverket*).

Receivables

Due perfection of a pledge of receivables is created by way of notice to the debtor and the pledgor being restricted from receiving payments of such contractual claims.

In respect of so-called negotiable promissory notes (*löpande skuldebrev*), being bearer instruments of the value, due perfection requires that such promissory notes are handed over to the pledgee.

Cash in Bank Accounts

A pledge over cash deposited in a bank account is perfected by way of notice to the account bank and the pledgor being restricted from disposing of the funds in the bank account.

5.2 Floating Charges and/or Similar Security Interests

General Security Concepts

There is no general security interest recognised under Swedish law which covers all assets of the security grantor. However, security can be taken over business mortgages (floating charges), represented by business mortgage certificates, covering certain moveable property, such as inventory, claims and similar, of the security provider. A business mortgage does not include cash, proceeds in bank accounts, shares or other financial instruments.

There is no restriction on including different types of assets over which security is created under one general security agreement, but specific perfection requirements for each type of asset should then be taken into account. However, there will typically be different security agreements covering different types of assets subject to security in Swedish loan financings.

5.3 Downstream, Upstream and Cross-Stream Guarantees

Swedish limited liability companies (*aktiebolag*) may not grant monetary loans, security or a guarantee for monetary loans to shareholders, board members, managing directors, certain relatives and spouses/co-habitants (*sambo*) to any such person, or persons who, alone or together with someone, has a controlling influence in the

company or another company within the same group.

A "group" means any other group of undertakings of corresponding nature in which the parent company is:

- a Swedish legal entity which is obliged to maintain accounts pursuant to the Swedish Accounting Act (*bokföringslagen*);
- a corresponding foreign legal entity domiciled within the EEA; or
- a municipality, county council or association of local authorities.

However, there are exemptions in cases where the borrower is a municipality or similar, or if the loan has been borrowed by the Swedish National Debt Office pursuant to Chapter 5 of the Swedish Budget Act (*budgetlagen*). Further, there is an exemption where the borrower is a company within the same group as the lending company, or where the loan is intended exclusively for the borrower's business operations and the company provides the loan for purely commercial reasons.

There is also an exemption regarding loans and granting of security to a shareholder or connected persons where the total shareholding in the company held by the borrower and connected persons does not amount to 1% of the share capital.

Advances, loans or security may, however never be provided where full coverage for the restricted share capital is thereafter not available. When calculating whether full coverage for the restricted share capital is available, advances and loans pursuant to the first paragraph shall be treated as receivables of no value, and security pursuant to the first paragraph shall be treated as a liability of the company.

Further, transactions where a limited liability company provides a loan or grants a security or guarantee may be limited or even void if the transaction reduces the limited liability company's net worth and such transaction is not deemed to have corporate benefit for that limited liability company. These transactions are referred to as value transfers under Swedish law. As regards downstream guarantees, these are typically considered to have corporate benefit if the subsidiary is wholly owned by the parent company and the subsidiary is not insolvent. In relation to upstream or cross-stream guarantees, the limited liability company guaranteeing obligations of another legal entity must carefully consider if the transaction has sufficient corporate benefit, which in many cases may be that the subsidiary accesses more favourable financing terms and conditions on a group basis.

5.4 Restrictions on the Target

A Swedish limited liability company (*aktiebolag*) is generally prohibited from granting an advance, providing loans or providing security for loans in order for the debtor or any natural or legal person connected thereto (as referred to in Chapter 21, Section 1 in the Swedish Companies Act) to acquire shares in the company or any parent company in the same group. This financial assistance prohibition does not generally cover refinancings or security take-ups involving the target company, and which are made some time (market standard is somewhere between approximately 30 and 90 days) after the acquisition of the target company has been completed.

5.5 Other Restrictions

There are no other specific major general restrictions, consents required to approve, or signifi-

cant costs associated with granting security or guarantees under Swedish law. However, the issuance of new business mortgage certificates and property mortgage certificates will require a stamp duty to be paid in connection with the issuance. Such stamp duty is a one-time cost, and such certificates may be reused after issuance without additional stamp duty to be paid.

Business Mortgage Certificates

The stamp duty for the issuance of a new business mortgage certificate currently amounts to 1% of the face value of the business mortgage certificate.

Property Mortgage Certificates

The stamp duty for the issuance of a new property mortgage certificate currently amounts to 2% of the face value of the business mortgage certificate.

5.6 Release of Typical Forms of Security

Release mechanisms are usually governed by the relevant security agreement in addition to a general release clause typically included in an intercreditor agreement. Intercreditor agreements governing the release of assets pledged under Swedish law generally give the security agent a discretionary power to release the relevant security, since automatic release clauses may negatively affect the perfection of the relevant security interest.

Release of Security Over Monetary Claims

Release clauses in relation to security over monetary claims, such as insurance proceeds, claims under material contracts and similar, usually require the security agent on behalf of the lenders to notify the relevant debtor of the security release.

Release of Security Being Held in the Possession of the Pledgee

Release clauses in relation to pledged assets that have been perfected by way of coming into the possession of the pledgee, usually require that the pledgee returns the relevant asset to the pledgor. This applies to, for instance, non-electronic business mortgage certificates, non-electronic property mortgage certificates and share certificates.

Release of Security Registered in a Certain Register

Release clauses in relation to security that has been registered in a certain register usually require a deregistration of such security interest to be made in the relevant register. This applies to, for instance, electronic business mortgage certificates, electronic property mortgage certificates as well as shares and other securities registered with a securities depositary.

5.7 Rules Governing the Priority of Competing Security Interests

Priority of Competing Security Interests

Parties involved in a Swedish loan financing do generally deal with competing security interests by way of entering into a subordination agreement or an intercreditor agreement, in which a contractual priority between different lenders or group of lenders may be created. Such agreements are generally based on LMA standards.

A duly perfected security interest in relation to a certain asset will generally have priority ahead of other claims such as third-party creditors or a bankruptcy receiver in the pledgor's bankruptcy. However, there are claw-back periods to be considered in this regard; see **7.1 Impact of Insolvency Processes**.

Reference is made to **7.2 Waterfall of Payments** for an overview of the priority between creditors in the event of a bankruptcy.

5.8 Priming Liens

Other Third-Party Security Interests

Third-party security interests can, in some cases, be created by operation of law.

A retention of title of certain goods and assets can result in a seller of such goods or assets having better priority than a secured lender. A valid retention of title must, among others, be created prior to the relevant goods or assets being transferred. Also, if the buyer of the goods or assets is permitted to consume or sell the goods or assets, this may negatively affect the validity of the retention of title.

Certain moveable property remaining in the possession of the seller may have priority ahead of other creditors if the sale has been duly registered with the Swedish Enforcement Authority (*Kronofogdemyndigheten*).

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Enforcement of security is typically made as an auction sale. Under Swedish law, a pledgee has a fiduciary duty to take into account the interest of the pledgor when enforcing the security. This means that the pledgee should seek to realise a fair market value for the asset being realised, given the circumstances at hand.

Further, a security may only be enforced to the extent it is covered by the debt secured by the security, and any excess cash from an enforcement sale should be paid to the pledgor.

Security agreements generally regulate the circumstances under which security may be enforced. If the parties have not agreed on how enforcement should be carried out, the pledgor may seek enforcement assistance with the Swedish Enforcement Authority.

Enforcement of property mortgage certificates and business mortgage certificates are limited to be made through a public sale process at the Swedish Enforcement Authority.

In addition, there is a forfeiture prohibition under Swedish law restricting a pledgee from assuming ownership of the pledged asset if such acquisition is not made in fair competition of other potential acquirers on the market, which further strengthens the reasons to arrange an auction sale of the relevant asset.

6.2 Foreign Law and Jurisdiction

Swedish courts generally recognise the choice of foreign law to govern contracts, subject to conflicts with public policy (*ordre public*) and foreign law contracts may be enforced in Sweden provided that Sweden has jurisdiction over them. Waivers of immunity are generally legally binding and enforceable under Swedish law.

6.3 Foreign Court Judgments

Judgments given by a foreign court may be enforceable in Sweden under the Haag convention, Brussels I convention, or Lugano convention.

Arbitral Awards

Sweden is a party to the 1958 New York Convention, meaning that all arbitral awards issued by a connected party thereunder are enforceable in Sweden.

6.4 A Foreign Lender's Ability to Enforce Its Rights

There are generally no restrictions in relation to a foreign lender's ability to enforce its rights under a Swedish law-governed loan agreement or Swedish law-governed security agreement.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

Swedish entities that have been declared bankrupt will, by operation of law, have their assets managed by an appointed bankruptcy receiver which will manage the insolvency process and ensure that the total assets of the bankruptcy estate, after certain deductions, are being distributed among the relevant creditors in a certain order. Perfected security may still be enforced by way of auction sale in such scenario even though an insolvency process may delay the sale process of certain assets.

It may be noted that there are different types of claw-back periods under Swedish law, which means that certain transactions may be recovered by a bankruptcy receiver to the bankruptcy estate if such transaction has been made within the relevant claw-back period. For example, there is a three-month long claw-back period regarding new security granted provided in respect of existing debt, which generally affects security assets with delayed perfection.

7.2 Waterfall of Payments

Under Swedish law, there are several tiers of priority between creditors in the event of insolvency of a borrower:

- special priority right, being claims that are connected to a particular collateral (such as security over real property or other pledge);
- general priority right, for instance costs that are connected to initiate the insolvency proceeding;
- unprioritised claims, being everything else. Any assets remaining after creditors under the first two bullet points above have been paid should be divided between the creditors in this category; and
- subordinated claims.

The priority order of special priority rights is listed in Section 3a–7 in the Swedish Priority Rights Act (*förmånsrättslag*). Before any creditors are paid in the above priority order, certain costs related to the operations of the bankruptcy estate as well as fees to the bankruptcy receiver should generally be paid. Any remaining amount after repayment of debt has been made in full should be distributed among the shareholders.

The concept of secondary pledge is available under Swedish law, where two creditors may agree that a secondary pledge is made in an asset, where the secondary pledgee has secondary right to the pledge.

Parties involved in a Swedish loan financing do generally deal with competing security interests by way of entering into a subordination agreement or an intercreditor agreement, in which a contractual priority between different lenders or group of lenders may be created. Such agreements are generally based on LMA standards.

7.3 Length of Insolvency Process and Recoveries

If a company itself submits a bankruptcy filing to the relevant court, the court usually dispatches its decision on the very same day. If a creditor files for bankruptcy, the court will generally take up to two weeks or more due to negotiations between the parties involved.

The insolvency process itself can vary in length, from a few weeks to many years. The bankruptcy receivers are obliged by law to ensure that all assets are managed in the best way possible and that the priority order between different creditors is followed.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Reorganisation of Companies

Companies with temporary financial problems may apply for a company reorganisation (*företagsrekonstruktion*) in order to achieve a more viable financial situation by way of not allowing enforcement actions taken by creditors during the reorganisation period. Part of a reorganisation is also generally to make compositions with the creditors by way of reaching an agreement to reduce the company's debts to some extent.

As of 1 August 2022, a new Swedish Reorganisation Act came into force implementing the EU Directive on Restructuring and Insolvency. There are some key aspects introduced in the new Act. Courts should generally apply a stricter approach when assessing whether a reorganisation is appropriate for the relevant company, this is referred to as the so-called viability test. Also, a legally binding reorganisation plan may be established, which should, among others, set out the parties involved, actions to be taken during the reorganisation as well as timing aspects thereof. Further, conversion of debt to equity (by way of debt-to-equity swaps) can be made part of the binding reorganisation plan. Another new element is that cross-group cram-downs may not only include unsecured creditors, as was the case previously, but also secured creditors. The new Swedish Reorganisation Act substantially amends the measures that may be taken in connection with a company reorganisation.

7.5 Risk Areas for Lenders

If the borrower, security provider, or guarantor were to become insolvent, the lenders would face the risk of not receiving part of or the entire loan amount (including interest, both accrued and future). Lenders may also need to take into account claw-back periods of security granted and to ensure that any security granted to the lender is duly perfected.

8. Project Finance

8.1 Recent Project Finance Activity

For some years, there has been a high activity of onshore wind power projects in Sweden due to an increased level of transition to renewable energy, which have been fuelled by political promotion of such energy sources. These projects are mostly located in non-residential areas in the northern, and to some extent in the southern, part of Sweden. Large wind power parks have been built and financed by project financing during the establishment phase and then sold to, for instance, large institutional investors. These project financings are often complex and generally attract interest from foreign lenders and investors.

8.2 Public-Private Partnership Transactions

Public-private partnership (PPP) transactions are not very common in Sweden. Two high-profile PPP's in Sweden have nevertheless been the construction of Nya Karolinska, a hospital located in Stockholm, and the construction of Arlanda Airport Express, a railway from the city of Stockholm to Arlanda Airport.

8.3 Governing Law

Swedish courts generally recognise the choice of foreign law to govern contracts, subject to

conflicts with public policy (*ordre public*) and foreign law contracts may be enforced in Sweden provided that Sweden has jurisdiction over them. Project documents may therefore be governed by foreign law but it should be noted that certain documents should take local law requirements into account, such as security agreements where Swedish law perfection requirements will affect the perfection of such security. Further, issues that are governed by local legal principles that may not be negotiated are issues that will always be governed by local law, regardless of whether the parties have agreed that the issue will be governed by foreign law.

English and New York local court judgments are as a main rule not recognised or enforceable in Sweden without a retrial of the merits of the case. However, the foreign judgment may provide strong evidence in the case. Certain English court judgments in civil and commercial matters may be recognised and enforceable in Sweden pursuant to the Hague Convention, which applies to certain international cases with exclusive choice of court.

International arbitration is always available to the parties, where arbitration is possible.

8.4 Foreign Ownership

The Swedish Parliament is expected to approve a new law in relation to foreign direct investments (the "FDI Act"), which should enter into force on 1 December 2023. The FDI Act is intended to protect national security interests of Sweden by way of, among others, imposing notification requirements prior to foreign direct investments in Swedish companies conducting certain protective activities being made. Such businesses include, for example, security-sensitive services, certain technology, equipment used in the military sector, raw materials and similar. Foreign direct investments in such companies of at least 10% of the total shares or votes will require a prior notification to, and approval by, the Swedish Inspectorate of Strategic Products (*Inspektionen för Strategiska Produkter*). Non-compliance with the FDI Act may result in fines of up to SEK100 million. The FDI Act will have significant impact on many transactions and may delay and/or restrict certain foreign direct investments.

8.5 Structuring Deals

As described further in **5.4 Restrictions on the Target**, there are financial assistance restrictions under Swedish law which need to be taken into account in relation to Swedish acquisition financings in respect of a target company being a Swedish limited liability company. In short, this means that such target company may not, with a few exemptions, provide loans or grant security for the acquisition of the shares in the target company itself.

Further, corporate benefit issues may also need to be carefully considered when structuring deals so that companies granting security or guarantees are deemed to receive sufficient corporate benefit from the transaction at hand. In many deals, corporate benefit for a group company granting security or guarantees for the benefit of its parent company may result in the whole group receiving financing on terms and conditions not available for a company on a standalone basis.

8.6 Common Financing Sources and Typical Structures

The main part of the Swedish project finance activity relates to renewable energy projects and more specifically onshore wind power projects. The typical financing source for these projects are bank loans borrowed by a project company, being a special purpose vehicle established

for the specific project. Such project company generally enters into the relevant finance agreements, in many cases guaranteed by a parent company. The structure is set up to facilitate a sale of the whole project to a third party at a later stage. Sponsors generally contribute capital to supplement the loan financing. Lenders are most commonly based within the EU and the financings are either bilateral financing arrangements or syndicated deals.

8.7 Natural Resources

The level of natural resources is high in the northern part of Sweden where many large companies have started high-profile green industrial projects. These business projects are often complex, capital-intensive and may encounter issues with local property owners (in many cases municipalities), local infrastructure and environmental permits.

8.8 Environmental, Health and Safety Laws

Environmentally hazardous activity requires an environmental permit pursuant to the Swedish Environmental Code (*Miljöbalken*). Certain projects may therefore need environmental permits, which should be taken into account in project financings. Most applications for environmental permits are submitted with the local County Administrative Board, while projects, such as mining and industrial projects, having a more significant environmentally hazardous impact should obtain an environmental permit from the relevant Land and Environment Court (*Mark- och miljödomstolen*). Such processes will generally involve consultation with other parties concerned by the contemplated environmentally hazardous activities, which in many cases may be time consuming.

The Swedish Work Environment Act (*Arbetsmiljölagen*), supplemented by certain rules issued by the Swedish Work Environment Authority (*Arbetsmiljöverket*), generally regulates the work environment, and aims to prevent work accidents, ill health and foster a good work environment.

SWITZERLAND

Law and Practice

Contributed by:
Shelby R du Pasquier, Patrick Hünerwadel, Valérie Menoud and Marcel Tranchet
Lenz & Staehelin

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Lenz & Staehelin

Lenz & Staehelin has the largest banking and finance team in Switzerland, with approximately 80 specialised lawyers offering leading expertise on transactional and regulatory matters. The firm acts for a strong domestic and international client base, and is involved in a high proportion of the most significant matters in Switzerland. The team advises on the full range of banking and finance matters, including financings, regulatory matters, regulatory proceedings, capital markets, asset management, derivatives, private banking, fintech and ESG-related matters.

Authors

Shelby R du Pasquier heads the banking and finance team at Lenz & Staehelin's Geneva branch and focuses on banking and financing services, investment funds, corporate and M&A, and internal investigations. He is the author of numerous articles and guides, and is admitted as an expert to the SIX Swiss Exchange for Listing Purposes. He is also a board member of several listed and private companies, including the Swiss National Bank, and is the chair of the supervisory board of the Pictet Group.

Patrick Hünerwadel is a partner at Lenz & Staehelin, and active in structured finance, aircraft financing, asset securitisation, and capital markets matters, among others. Patrick has contributed to several publications in the field, and lectures on corporate law and contracts at the University of St Gallen.

Valérie Menoud is a partner specialising in banking and regulatory matters at Lenz & Staehelin. Her practice also covers contract and corporate law, anti-money laundering, compliance issues and corporate investigations. She regularly contributes to industry publications and has been a part-time lecturer at the University of Lausanne (HEC).

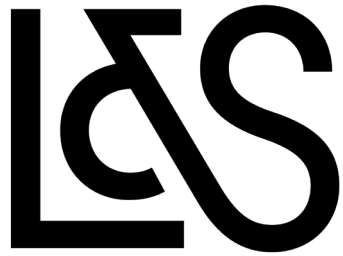
Marcel Tranchet heads the banking and finance team at Lenz & Staehelin in Zurich. His practice includes syndicated financings, acquisition finance, structured finance, project finance, bond offerings and other securities transactions, financial restructurings, derivatives, regulatory matters and fintech matters. Marcel is the author of various articles and guides, and a frequent speaker at conferences.

Contributed by: Shelby R du Pasquier, Patrick Hünerwadel, Valérie Menoud and Marcel Tranchet,
Lenz & Staehelin

Lenz & Staehelin

Route de Chêne 30
CH-1211 Geneva 6
Switzerland

Tel: +41 58 450 70 00
Fax: +41 58 450 70 01
Email: geneva@lenzstaehelin.com
Web: www.lenzstaehelin.com



1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

The lending market in Switzerland is well developed, with experienced participants (lenders, borrowers and advisers). The Swiss lending market has been stable for many years now, including during the 2008 financial crisis, the COVID-19 pandemic and the war in Ukraine. The Swiss market is largely in the hands of Swiss banks, but non-Swiss banks and alternative lenders (such as specialised debt funds) play an important role as well.

Tax incentives – as well as the negative interest rates introduced by the Swiss National Bank in 2015 and subsequently by most banks – have had the effect of fostering investments and supporting loan market activities. However, over the past year, the Swiss National Bank has decided to raise interest rates several times to counter inflation. Nonetheless, the impact of rising interest rates on the Swiss loan market has been moderate overall compared to other countries.

The Swiss Financial Market Supervisory Authority (FINMA) is keen to ensure that lending is sustainable and that the solvency of banks is not put at risk as a result of over-lending. FINMA monitors banks to ensure that they have sufficient capital to withstand changes in risk-drivers. The continuing pressure on profitability may result in banks taking on increased risks in lending or in interest rate risk management, according to FINMA.

1.2 Impact of the Ukraine War

Following Russia's invasion of Ukraine, global economic growth has slowed down and central banks across the world have tightened monetary policy. In particular, the increased volatility in financial markets, the rise of energy prices and the high inflationary pressure led the Swiss National Bank to increase interest rates for the first time since 2015.

That being said, there are currently no signs of major impacts on the Swiss loan market, compared to other financial centres. However, uncertainty over the future direction of inflation, interest rates and economic growth present risks and challenges to both lenders and borrowers.

Of note, Switzerland has adopted sanctions that are, in principle, aligned with those adopted by the EU in response to Russia's ongoing military aggression against Ukraine.

1.3 The High-Yield Market

High-yield debt securities have been an increasingly popular means of external debt financing during the past few years.

Large transactions, especially leveraged transactions, are frequently structured both with loans and high-yield debt. For Swiss withholding tax reasons, the notes' issuer is often a non-Swiss entity.

1.4 Alternative Credit Providers

Alternative credit providers (eg, specialised debt funds, pension funds and insurance companies) have been increasingly active in the Swiss market, especially in international leveraged transactions. The "Swiss non-bank rules" (see **4.1 Withholding Tax**) are an element to be considered when structuring such transactions.

As regards debt securities transactions in Switzerland, these are generally co-ordinated by banks (Swiss or non-Swiss) with a broader investor base than in the bank loan market.

1.5 Banking and Finance Techniques

As mentioned in **1.4 Alternative Credit Providers**, alternative credit providers have been increasingly active in the Swiss market during the past few years.

The use of crowdfunding to finance projects has shown relatively stable growth over the past few years in Switzerland. Under current Swiss rules, crowdfunding is not subject to specific regulatory requirements. Similarly, crowdfunding platforms are not subject to licensing requirements for the time being.

Platform operators have to be careful, however, to comply with the traditional banking rules and structure their activities in a way that does not trigger a licensing requirement under banking laws. This could, for instance, be the case where the operator accepted deposits from the public. Platform operators' activities are also generally subject to anti-money laundering regulations.

1.6 ESG/Sustainability-Linked Lending

As is the case in other leading financial centres, ESG and sustainability-linked lending is a major topic in Switzerland and is a feature of many transactions, especially syndicated loan transactions and, albeit to a lesser degree, large bilateral loan transactions.

No uniform approach has yet developed but market practice is starting to crystallise more and more, especially in terms of:

- the relevant triggers (key performance indicators are the most common triggers);
- reporting; and
- the implications (eg, margin increase/decrease).

To date, these efforts largely rely on voluntary standards, such as the Loan Market Association recommendations for the bank debt market or the International Capital Market Association principles for the debt capital market.

This development ties in with greater regulatory efforts to better assess how issuers take ESG aspects into account. In this context, it is worth noting that the Swiss stock exchange (SIX Swiss Exchange) has launched ESG indices – based on data from the Swiss sustainability-rating agency Inrate – for its equity and bond markets.

Furthermore, a 2022 revision of Swiss corporate law introduced new provisions on ESG reporting into Swiss law. These provisions notably require large Swiss companies and regulated financial

institutions to publish a non-financial report annually, for the first time for the financial year 2023, to be published in 2024. This report will focus on information related to the company's business development, performance, position, and impact on environmental, social, employee, human rights and anti-corruption matters.

2. Authorisation

2.1 Providing Financing to a Company

Lending activities are generally unregulated in Switzerland, provided the lender does not accept deposits from the public or refinances itself via a number of banks. A Swiss-based entity that combines lending activities with deposit-taking from the public or refinancing from a number of banks will generally qualify as a bank, which triggers licensing requirements under Swiss banking laws.

The Swiss regime for the cross-border provision of financial services, including lending to Swiss borrowers, is still rather liberal. Foreign-regulated entities operating on a strict cross-border basis (without having a business presence in Switzerland) do not need to be authorised by FINMA, as a general rule. If, however, these activities involve a physical presence (such as personnel or physical infrastructure) in Switzerland on a permanent basis, the cross-border exemption is generally not available. In practice, FINMA considers a foreign entity to have a Swiss presence as soon as employees are hired in Switzerland. That said, FINMA may also look at further criteria to determine whether a foreign bank has a Swiss presence, such as the business volume of that bank in Switzerland or the use of teams specifically targeting the Swiss market.

This liberal stance has changed somewhat with the introduction of the Swiss Federal Financial Services Act (FinSA) and the Swiss Federal Act on Financial Institutions (FinIA). These statutes respond to the "third-country rules" of MiFID II (the EU's Markets in Financial Instruments Directive 2014) and introduce an obligation to register in Switzerland for foreign financial service providers that would be subject to an authorisation in Switzerland, as a prerequisite to providing financial services to Swiss-based investors. Certain exemptions are available for regulated financial institutions targeting exclusively institutional and professional clients in Switzerland.

Lending to individuals for purposes other than business or commercial activities (ie, consumer credits) is regulated by the Swiss Consumer Credit Act (SCCA). Lenders contemplating consumer credit activities falling under the SCCA must register with the canton in which they are established. Exemptions from this registration requirement are available for Swiss-licensed banks and for lending services that are ancillary to the commercial activity of the lender (ie, for the purpose of financing the acquisition of goods or services provided by the lender itself).

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

With the exception of consumer credit activities, foreign lenders are not – as a general rule – restricted from granting loans to Swiss-based borrowers under Swiss law (see **2.1 Providing Financing to a Company**). Certain Swiss tax law points are to be considered where security is taken over Swiss real estate assets (see **3.2 Restrictions on Foreign Lenders Receiving Security**).

3.2 Restrictions on Foreign Lenders Receiving Security

There are no generally applicable Swiss law provisions restricting or prohibiting the granting of security or guarantees to foreign lenders in Switzerland – for example, there are no restrictions on the basis of national interest. That said, depending on the nature of the collateral, the type of security interest and the industry sector, specific restrictions may apply or may impact the enforcement of the security interest by a foreign secured creditor.

Real Estate Financing

One noteworthy example is the area of real estate financing transactions in Switzerland. The background is that the acquisition of Swiss real estate assets by foreign investors or foreign-controlled companies is subject to restrictions under the Swiss Federal Law on the Acquisition of Real Estate by Persons Abroad (the so-called Lex Koller).

In particular, residential properties can only be acquired by foreign investors or foreign-controlled companies if a licence is issued (and such licences are granted on limited grounds). This generally covers both direct investments in residential real estate and acquisitions of shares in a residential real estate company. The concept of acquisition under the Lex Koller is such that it also includes secured financings by foreign lenders if those financings exceed certain thresholds – in particular, loan-to-value thresholds.

The acquisition of commercial properties, by contrast, is subject to fewer restrictions, which mainly concern premises that are:

- empty;
- contain residential parts; or
- that are acquired in anticipation of expansion plans but without concrete plans to build at the time of acquisition.

In addition to this Lex Koller point, a Swiss tax at source can apply where the security package of a financing by foreign lenders includes Swiss real estate assets. Exceptions apply if the foreign lenders act through jurisdictions with a double taxation treaty that provides for full exemption from such tax.

Regulated Sectors

In certain regulated industries – for example, the financial sector (in particular, banking), telecommunications, nuclear energy, media and aviation – shareholders and controlling interests in companies active in the sector may be subject to review and approval by the competent Swiss authority, with a view to ensuring proper business conduct and, as the case may be, reciprocal rights for Swiss investments abroad. Such restrictions can also apply in the case of secured financings to companies in such sectors.

Control of Foreign Investments

In May 2022, the Federal Council initiated the consultation on a preliminary draft bill entitled the Swiss Federal Act on the Control of Foreign Investments, which seeks to introduce foreign investment control in Switzerland. The preliminary draft provided for a cross-sector (as well as a sector-specific) review of acquisitions by foreign investors. Accordingly, an acquisition by a foreign investor of certain Swiss companies (eg, those active in research, development and the production and distribution of medicines) and systemically important Swiss banks would need to be approved by the State Secretariat for Economic Affairs. The preliminary draft bill encountered general scepticism and the Federal Council will substantially revise its proposal. It is

expected that the Federal Council will present a more targeted bill to Parliament at the end of 2023 which will provide for investment screening when a foreign state-controlled investor aims to acquire a Swiss company operating in a sector critical to Switzerland's security (eg, defence equipment, electricity transmission and production, or health and telecoms infrastructure).

3.3 Restrictions and Controls on Foreign Currency Exchange

There are no restrictions or controls on foreign currency exchanges or on the import and export of capital under Swiss law.

3.4 Restrictions on the Borrower's Use of Proceeds

There are no specific statutory restrictions on a Swiss borrower's use of proceeds from loans or debt securities under Swiss law. Parties do, however, generally agree contractually on the permitted use of funds.

3.5 Agent and Trust Concepts

Swiss law does not provide for specific rules governing the use of agency or trust structures in the context of secured lending transactions. However, such concepts are recognised and commonly used in practice.

As a rule, it is possible under Swiss law that security be granted to, and held by, an agent or trustee and for security documents to be drafted in such a way that it is not necessary to amend them upon a change of the secured parties. Depending on the type of security interest, the role and powers of the agent or trustee need to be structured differently.

- Where the security interest is a security assignment or a security transfer, the security can be held on trust – that is, by a security agent acting in its own name and for the benefit of the (other) secured parties.
- By contrast, where the security interest is a right of pledge, it is necessary that the security agent act as a direct representative of the (other) secured parties (ie, in the name and on behalf of the secured parties) because a Swiss law pledge is accessory to the secured obligations. This requires that the secured parties be identical to the creditors. Having the security agent act as a direct representative is the standard approach in Switzerland to address this. Alternative approaches (such as parallel debt) remain untested in Swiss courts, but practitioners generally take the view that the "parallel debt" concept should work under Swiss law.

With regard to trusts in particular, it should be noted that currently a substantive trust law does not exist in Switzerland. It is therefore not possible to set up a trust under Swiss law. That said, foreign trusts – as defined under the Hague Convention on the Law Applicable to Trusts and on their Recognition of 1985 (which Switzerland ratified in 2007) – may be recognised in Switzerland. This recognition is governed by the Swiss Private International Law Act (PILA).

This situation may change. The Federal Council issued a preliminary draft bill in January 2022 aimed at introducing the trust as a new legal institution into Swiss law and governing its taxation. Depending on the results of the consultation, which ended on 30 April 2022, a bill will be prepared for discussion by Parliament, likely during its 2023 sessions.

3.6 Loan Transfer Mechanisms

Loan transfers are generally achieved either by way of an assignment of a lender's rights under a credit facility or by a transfer of its rights and

obligations. Swiss law does not provide for general restrictions on such mechanisms. However, parties to a facility agreement frequently restrict such assignments and transfers contractually by subjecting them to a borrower's consent regime, such that the borrower's consent is required unless an exemption applies (eg, assignments or transfer upon the occurrence of an event of default or to an existing lender or an affiliate). Under Swiss law, a debtor does not need to be notified of the assignment of rights for it to be valid. However, a non-notified debtor may still validly discharge its obligations into the hands of the assignor. As mentioned in **3.5 Agent and Trust Concepts**, a loan can also be transferred pursuant to Swiss law. In such a case, the lender – with the agreement of the borrower - will transfer its rights and obligations relating to the loan agreement to a new lender.

Security interests of an accessory nature, such as a right of pledge, will follow the claims they secure when transferred. Security interests of an independent nature (such as security assignments, security transfers or certain types of personal guarantees) will, in principle, not automatically follow the claims they secure and must be transferred expressly with the consent of the security provider. As a result, it is generally recommended to expressly assign and respectively novate the security package to the benefit of the new lender in the case of a loan transfer. However, if the relevant security documents are prepared with a security agency concept, there is no need to assign or transfer the security package.

Finally, assignments and transfers are subject to continued compliance with the Swiss non-bank rules (see **4.1 Withholding Tax**).

3.7 Debt Buy-Back

There is no specific Swiss regulation addressing debt buy-backs, provided the debt instrument does not offer an equity option or a conversion feature.

In practice, where finance documents address the question of debt buy-backs, such transactions are generally contractually prohibited or restricted. In some cases, the parties may also provide that the participation of a borrower or financial sponsor (or other affiliates) will be disregarded when it comes to voting matters.

3.8 Public Acquisition Finance

Swiss takeover laws provide for "certain funds" rules and requirements that must be complied with in the context of public takeovers. These are generally similar to other well-known standards, such as the certain funds standards in the UK. In a nutshell, details about the financing of the transaction have to be included in the offering prospectus and a review body has to confirm that the bidder has the necessary funds available (or has taken measures to ensure their availability).

With regard to private M&A transactions, Swiss law does not provide for certain funds requirements. In this area, the matter is up to the parties to negotiate, and contractual clauses on funding certainty vary in practice. In domestic acquisitions, where the parties are non-financial entities, the threshold of certain funds is often low and accompanied by a "highly confident letter" or with a term sheet from a bank.

In certain instances (eg, in smaller transactions) a seller may even accept that the acquisition be subject to financing (ie, a financing-out). By contrast, in larger transactions, certain funds requirements are typical and the threshold is

often a high one – sometimes higher than it would be for a public takeover.

3.9 Recent Legal and Commercial Developments

No recent legal and commercial developments have had a major impact on the legal documentation, other than the transition from IBORs to risk-free rates and the increasing importance of sustainability-linked transactions.

3.10 Usury Laws

Except in the area of consumer credit, where a maximum interest rate is set and revised each year by the Swiss Federal Department of Justice and Police, there are no specific rules limiting the amount of interest that can be charged on a loan. However, high interest rates might be considered excessive and be subject to general Swiss law principles on usury.

In this context, the maximum allowable rate of interest is to be determined by various factors and circumstances of the case (eg, the currency of the loan and the corresponding inflation, the duration of the loan or the risk associated with a financing). There is no clear test or threshold, but practitioners and scholars usually agree on a limit in the range of 15–18% per annum. Swiss law also prohibits compound interest so that default interest due cannot itself bear default interest.

3.11 Disclosure Requirements

Public companies must provide their debt positions in their annual financial statements according to Swiss stock exchange rules (the disclosure of the details is not required however).

4. Tax

4.1 Withholding Tax

Generally, under Swiss domestic tax laws, interest payments by a Swiss borrower under a loan are not subject to Swiss withholding tax. By contrast, interests on bonds are subject to Swiss withholding tax (currently at a rate of 35%).

In order to avoid a requalification of a loan facility into a bond issuance (ie, a financing from the public) and the levy of Swiss withholding tax on payments under such financing, the so-called Swiss non-bank rules have to be complied with. Under such rules, a facility is at risk of being requalified into a bond issuance if:

- more than 10 non-bank lenders participate (or sub-participate) in the facility agreement (the "10 non-bank rule");
- a Swiss obligor has more than 20 non-bank creditors (the "20 non-bank rule") on an aggregate level (ie, all of its lenders and not just the lenders in a particular transaction); or
- a Swiss obligor has, on an aggregate level, more than 100 non-bank creditors under financings that qualify as deposits within the guidelines issued by the tax administration (the "100 non-bank rule").

Under these rules, a bank is generally defined as a financial institution that is licensed as a bank in Switzerland or abroad and carries out typical banking activities with infrastructure and personnel of its own. Non-compliance with the Swiss non-bank rules can result in the application of Swiss withholding tax, which has to be withheld by the Swiss obligor. As the case may be, this tax might be (partly or fully) recovered by a lender, depending on any applicable double taxation treaty.

It is noteworthy that the Swiss non-bank rules also apply where there is no Swiss borrower but there is a Swiss guarantor or security provider. Depending upon the structure, various approaches are available in such transactions to address the Swiss non-bank rules.

Finally, one should note that Swiss withholding tax laws generally prohibit a Swiss obligor from indemnifying a lender for Swiss withholding tax, so that standard gross-up clauses will not typically be valid and enforceable in Switzerland. In practice, there is an attempt to achieve the same commercial result by including a provision in facility agreements that provides for a recalculation of the applicable rate of interest (if and to the extent that Swiss withholding tax should become applicable and the tax gross-up is not valid). Such clauses remain untested in Swiss courts.

The Swiss government presented a revision of Swiss withholding tax laws that aimed at doing away with the Swiss non-bank rules restrictions. The Swiss population eventually rejected the revision of the bill in a referendum in September 2022.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Aside from the Swiss non-bank rules discussed in **4.1 Withholding Tax**, tax issues may arise depending on the security package.

- First, Swiss tax at source can apply on financings by non-Swiss lenders where the security package includes Swiss real estate assets. Applicable double taxation treaties, if any, may provide for exemption from such tax.
- Second, the Swiss non-bank rules need to be considered and addressed where a Swiss entity acts as guarantor or security provider.
- Finally, the granting of a guarantee or security by a Swiss direct or indirect subsidiary for the obligations of a parent company (so-called upstream security) or a sister company (so-called cross-stream security) may trigger Swiss withholding tax on payments under the guarantee or on the enforcement of such security interests (see **5.3 Downstream, Upstream and Cross-Stream Guarantees**).

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Aside from the Swiss non-bank rules discussed in **4.1 Withholding Tax,** Switzerland may levy a withholding tax, if:

- interest is paid on loans granted by foreign lenders to borrowers in Switzerland, which are secured by collateral on Swiss real estate (see **4.2 Other Taxes, Duties, Charges or Tax Considerations**);
- an up/cross-stream security or guarantee is not granted at arm's length terms, the difference between the consideration granted and the consideration actually paid by the Swiss affiliate to the security provider (if any), which may constitute a hidden dividend distribution on which Swiss withholding tax is payable (see **4.2 Other Taxes, Duties, Charges or Tax Considerations**);
- a bank in Switzerland owes interest to a non-bank lender; or
- bonds are issued by foreign issuers, but guaranteed by their Swiss parent company – these bonds may be requalified as domestic issuances under certain conditions, thus triggering Swiss withholding tax on interest payment.

By being compliant with the Swiss 10/20 non-Bank rules, the interest payments paid by a Swiss obligor will not be subject to Swiss withholding tax on that basis. For this purpose, specific language is generally incorporated in the relevant loan documentation to make sure that the Swiss obligor is compliant with the above-mentioned rules.

Withholding tax on an up/cross-stream security or guarantee is also generally recoverable if the recipient or beneficiary is a Swiss-resident entity (subject to certain conditions). In the case of a non-Swiss resident, however, the withholding tax paid may only be recovered in part or entirely under the terms of a double tax treaty.

5. Guarantees and Security

5.1 Assets and Forms of Security

Security Packages

The type of security interest, as well as the applicable formalities and perfection requirements, will generally depend upon the particular security asset. Typically, in corporate lending transactions, a security package will consist of a combination of a pledge over shares, a security assignment of (certain) rights and receivables, a pledge over bank accounts and guarantees issued by certain group entities.

As a matter of Swiss law, the creation of a security interest requires parties to enter into a security document identifying the collateral (see also **5.2 Floating Charges and/or Similar Security Interests**) and determining the secured claims in a sufficient manner.

Generally speaking, the notification of a debtor is not required to create a secured interest. However, it is advisable to notify, given that a debtor can otherwise validly discharge its obligations into the hands of the security provider.

Formal requirements might apply for the security document to be valid – for example, mortgage arrangements must take the form of a notarised deed. Perfection requirements, however, will vary according to the type of security and collateral.

Financial instruments

With regard to financial instruments (such as shares), a right of pledge is typically granted. The creation of the right of pledge requires parties to enter into a security document. Perfection requirements vary, depending on the type of financial instrument. Certificated financial instruments must be physically transferred to the secured party or the security agent. If the certificates are registered, they must be duly endorsed – typically in blank. A specific regime applies to intermediated securities, which can be pledged either by a transfer of the intermediated securities to the account of the secured party or by virtue of an irrevocable written agreement (known as a control agreement) between an account-holder and the depositary institution – provided the institution complies with any instructions from the secured party.

Movable assets

With regard to movable assets, the most common form of security interests is the right of pledge. The perfection of a pledge requires, in addition to a valid security document, that the security provider transfer possession of the pledged asset to the secured party or to a third-party pledgeholder. In practice, this often collides with operational requirements and restrictions, meaning that typically no security is taken over movable assets (or is only taken over selected movable assets).

This requirement does not apply to publicly registered aircraft and ships. Similarly, a pledge over registered intellectual property rights (eg, patents, designs or trade marks) is typically also registered in the relevant intellectual property register.

Claims and receivables

Security over claims and receivables, such as receivables or rights under contracts, can be taken by means of a security assignment or a right of pledge. In practice, putting in place a security assignment is the typical approach. These arrangements allow for the transfer of the full ownership of collateral assets. The use of the title is, however, contractually limited to the liquidation of the assets in an enforcement scenario and the retention of the proceeds up to the amount of the secured claim.

The advantage of this form of security interest resides in the fact that, in the case of bankruptcy of a security provider, the collateral will not fall in the bankruptcy estate of the security provider (see **7.1 Impact of Insolvency Processes**). The assignment for security purposes requires a written agreement between the assignor and the security provider.

Bank accounts

Where bank accounts are concerned, the typical approach is to work with a right of pledge. One point to consider in connection with bank account security is that the bank will typically have a first-ranking security interest (and other preferential rights, such as a right of set-off) over its client's account by virtue of the applicable general terms and conditions. In practice, parties often attempt to obtain a partial or full waiver from the account bank for such priority rights. Where no full waiver is granted – and in order to perfect the then second-ranking security interest – it is required that the bank be given notice.

Real estate

Where security is taken over real estate, the security will take the form of a mortgage certificate or a mortgage. No other type of charge on real property is permitted under Swiss law. Mortgage certificates are usually preferred in practice, as they constitute negotiable instruments that can be pledged or transferred for security purposes. A mortgage certificate can take the form of a paperless registered mortgage certificate or a mortgage certificate on paper. Both types of mortgage are created and perfected by an agreement of the parties on the creation of the security right (by a notarised public deed) and an entry in the land register. Notary and registration fees vary, depending on the cantons where the real estate is located, and will often be calculated as a percentage of the secured amount.

5.2 Floating Charges and/or Similar Security Interests

Floating charges and similar security interests over all present and future assets of a company or blanket liens are not available under Swiss law. Such security interests are not in line with the Swiss law requirement that collateral be specifically identified.

In addition, the requirement that a security provider must transfer possession of movable assets to the secured party would render any "floating" charge over inventory, machinery, equipment or other movable assets excessively burdensome and impracticable.

5.3 Downstream, Upstream and Cross-Stream Guarantees

Under Swiss law, upstream guarantees (ie, guarantees for obligations of a direct or indirect parent company) or cross-stream guarantees (ie, guarantees for obligations of an affiliate other than a subsidiary) are subject to certain limitations and formal requirements.

Broadly speaking, upstream and cross-stream guarantees are treated like dividend distributions as far as formal requirements and substantive limitations are concerned. In particular, it is held that upstream or cross-stream guarantees should be limited to the amount of freely distributable equity; ie, the amount that could be distributed as a dividend. Otherwise, sums paid in excess of this amount could be deemed to represent an unlawful return of capital.

From a formal perspective, the granting of an upstream or cross-stream guarantee should be approved by both the board of directors and the general meeting of shareholders of the Swiss guarantor. In addition, payments under upstream or cross-stream guarantees may be subject to tax, including Swiss withholding tax.

By contrast, downstream guarantees are generally not subject to restrictions, except in particular circumstances – for example, if the relevant subsidiary is in substantial financial hardship or if it is not a wholly owned subsidiary of the guarantor.

5.4 Restrictions on the Target

When a Swiss target grants guarantees or other security interests for obligations of an acquirer, any such security interest would be upstream in nature and therefore subject to the limitations discussed in **5.3 Downstream, Upstream and Cross-Stream Guarantees**.

The following factors need to be taken into account in this respect.

- The articles of association of the Swiss target should expressly permit upstream financial assistance.
- The guarantees should be approved not only by the board of directors but also by the shareholders of the Swiss target company.
- The finance documents should include language that limits such upstream undertakings to the amount of freely distributable equity and provide for a compensation of the Swiss target by a security or guarantee fee, as well as include certain undertakings of the Swiss target to mitigate upstream limitations.
- Certain Swiss tax withholding issues should also be addressed in the finance documents.

Another issue that arises, in particular where the target is a listed company, is that of minority shareholders. If (and for as long as) a guarantor/security provider is not a wholly owned subsidiary of the parent entity whose obligations are to be guaranteed/secured, minority shareholder considerations can constitute a material issue/risk.

5.5 Other Restrictions

The main restrictions concerning the provision of security interests in the context of financings are those related to upstream and cross-stream undertakings (see **5.3 Downstream, Upstream and Cross-Stream Guarantees**).

Other restrictions might also apply depending on the context, such as bankruptcy legislation (for avoidance actions, see **7.5 Risk Areas for Lenders**) and general restrictions pertaining to the principle of good faith and public policy.

5.6 Release of Typical Forms of Security

A security is generally released through a release agreement and a release action. The release action depends upon the type of security interest that is to be released. Essentially, the release action will consist of "reversing" the actions that were necessary for the perfection of the security interest, such as a return of movable assets or share certificates, or the reassignment of rights and receivables. Also, it is good practice to notify all relevant parties (eg, account banks) of the release.

5.7 Rules Governing the Priority of Competing Security Interests

As far as real estate assets are concerned, the priority of competing security interests results from the time of entry of the mortgage or mortgage note into the land register. The same applies to the public register for aircraft and ships. The land registers contain all pre-existing security interests with rank and amount. Security interests on real estate may be established in a second or any lower rank, provided that the amount taking precedence is specified in the entry. When security interests of different ranks are created on real property, any release of higher-ranking security interest will not entitle the beneficiaries of lower-ranking security interest to advance in rank – unless an agreement providing for advancement in rank is recorded in the land register.

As far as movable assets and certificated shares are concerned, the perfection of a security interest requires a transfer of the particular asset to the secured party. As a result, third parties are not able to take and perfect subsequent security interest over these assets without the consent of the secured party, with the exception of good faith acquisitions. A third party acting in good faith will acquire a valid security interest over the assets, irrespective of the fact that the pledgor had no authority over the assets.

As far as rights and receivables are concerned, the order of priority is chronological, with the first security interest granted being senior to any subsequent security interest. Parties can, however, agree on a different ranking among themselves. Because there is no public register, legal due diligence is sometimes conducted to verify that the particular assets are free from third-party rights. Also, it is customary to obtain a respective representation and to provide for the necessary negative undertakings (no disposals, negative pledge, etc) in the relevant security document(s).

As a general rule, priority ranking can be contractually varied and Swiss law recognises agreements setting priorities. Any party having a first-ranking security interest can decide to waive its priority right. Generally speaking, contractual subordination provisions will usually survive in insolvency proceedings of a Swiss security provider. However, questions can arise - particularly regarding whether an insolvency official is bound to them – and, where things are unclear, it is not uncommon in practice to bolster the contractual arrangements of claims among different groups of creditors by means of security assignments.

5.8 Priming Liens

The concept of priming liens (ie, liens specifically approved by insolvency officials or courts for post-petition loans and taking security over existing liens) is a concept not known under Swiss law.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Security interests can be enforced if a secured party has a secured claim that is overdue. The relevant finance documents will generally define the enforcement trigger.

Under Swiss law, there are two main avenues for enforcing a security interest.

- First, the enforcement of a right of pledge can follow the rules set out in the Debt Enforcement and Bankruptcy Act (DEBA). Under the DEBA, the usual form of enforcement is a public auction sale. Assets may, however, be sold without a public auction if:
  - (a) they would lose value during the time required to prepare the auction;
  - (b) the costs for the safekeeping of the assets are unreasonably high;
  - (c) the assets have a market price (ie, are traded on a stock exchange); or
  - (d) all parties agree to the private sale.
- Second, where the collateral consists of pledged claims, movables or security papers (including mortgage notes), the parties are to a certain extent free to agree on a private foreclosure mechanism. Private enforcement is generally preferred in practice, as it can be processed more expediently and with a simpler process than enforcement under the DEBA. By contrast, if a security right consists of a security assignment or transfer, enforcement can only be effected by way of private enforcement, as title to the collateral has passed to a secured creditor precisely with such purpose.

Private enforcement can be achieved through a public auction, public offering or a private sale. If a private sale has been agreed upon in the relevant security document, it is advisable to arrange expressly in the security document for the right of a secured creditor to purchase the collateral itself. The value of the collateral will be determined based on fair market value and any surplus remaining after application of the proceeds to the secured amount would be paid out to the security provider. Private enforcement of a right of pledge is, subject to exceptions (eg, for intermediated securities), only available as long as no official enforcement proceeding under the DEBA has been initiated.

6.2 Foreign Law and Jurisdiction

A choice of a foreign law as the governing law of a contract is generally possible under Swiss law, save for specific contracts such as contracts with consumers. A choice of law to govern security documents, although binding for the parties, will not bind third parties.

Swiss courts will generally refuse to apply provisions of foreign law if this would lead to a result that would be incompatible with Swiss public policy. In addition, a Swiss court may apply provisions of a different law from the one chosen by the parties if important reasons call for it and if the facts of a case have a close connection with that other law.

Similarly, jurisdiction clauses are also generally binding, subject to certain exceptions.

With regard to immunity, if and to the extent a person is subject to immunity, waivers are generally not possible.

6.3 Foreign Court Judgments

As a rule, Swiss courts will generally recognise a final and conclusive judgment of a competent

foreign court. Recognition of a foreign decision may, however, be denied if:

- such a decision is manifestly incompatible with Swiss public policy;
- a party establishes that it did not receive proper notice;
- the decision was rendered in violation of fundamental principles of procedural law; or
- if the principle of ne bis in idem has been violated.

Where proceedings in relation to the same subject matter and between the same parties have been started earlier in another competent court, Swiss courts tend to neither enforce a judgment nor take up the case until a decision capable of being recognised in Switzerland is rendered by the foreign court.

As for arbitral awards, Switzerland is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and will recognise and enforce foreign arbitration awards pursuant to and to the extent provided for by that convention.

6.4 A Foreign Lender's Ability to Enforce Its Rights

As mentioned in **3.2 Restrictions on Foreign Lenders Receiving Security**, the purchase of Swiss real estate by foreign or foreign-controlled investors might be subject to approval by the Swiss authorities under the Lex Koller. Any acquisition of residential real estate assets in Switzerland by foreign or foreign-controlled investors, in particular, is subject to restrictions and permit requirements. If certain loan-to-value thresholds are exceeded, such restrictions and requirements can also apply to financings secured by Swiss real estate assets.

Furthermore, a lender's ability to enforce its rights under finance documents may be limited by the occurrence of a bankruptcy or insolvency event with the Swiss debtor (see **7. Bankruptcy and Insolvency**).

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

Once bankruptcy has been declared over a Swiss obligor, or a composition agreement with assignment of the Swiss obligor's assets has been approved, the Swiss obligor becomes insolvent. All its obligations become due and payable and the insolvent loses legal capacity to dispose of its assets. All of its assets will form part of the bankruptcy estate, including pledged assets. Private enforcement of any assets that are part of the bankruptcy estate is no longer possible. The enforcement of creditors' rights in this context will be governed by the DEBA.

Assets from which the legal title was transferred for security purposes, however, do not fall in the bankruptcy estate but remain with the assignee, respectively the transferee. These assets may still be privately enforced by the secured party. Any eventual surplus from liquidation must then be returned to the bankruptcy estate for distribution to other creditors.

Subject to avoidance actions (see **7.5 Risk Areas for Lenders**), the initiation of insolvency proceedings should not affect valid acts of disposition made prior to such an occurrence.

7.2 Waterfall of Payments

Unsecured creditors are ranked into three groups, with financial creditors typically falling into the third group. Secured creditors are sat-

isfied on a priority basis out of the enforcement proceeds of the relevant security assets.

7.3 Length of Insolvency Process and Recoveries

The time taken for an insolvency process to complete depends significantly on how complex the particular insolvency is and on what type of insolvency proceeding is being applied. It can range from a few weeks (in straightforward cases) to a few years (in complex cases).

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Switzerland does not provide for a system similar to Chapter 11 or comparable schemes available under the laws of certain European jurisdictions. However, Swiss law is fairly flexible in its ability to accommodate reorganisation procedures outside of a formal bankruptcy and is also fairly flexible with regard to its interaction with non-Swiss reorganisation schemes.

7.5 Risk Areas for Lenders

Under the DEBA, dispositions taken to disadvantage certain creditors prior to the opening of bankruptcy proceedings may be subject to avoidance actions. This includes acts of disposition of assets made against no consideration or against inadequate consideration during the year preceding the declaration of bankruptcy. It also includes acts taken during the five years prior to the opening of bankruptcy proceedings with the purpose of disadvantaging creditors or favouring some creditors to the detriment of others.

If a debtor was over-indebted at the time, the following acts may be voidable if carried out during the year prior to the opening of a bankruptcy proceeding:

- the granting of collateral for previously unsecured debt;
- the settlement of debt by unusual means of payment; or
- the repayment of debt not due.

Such acts are not voidable if the party that benefited from the act demonstrates that it did not have actual or deemed knowledge about a debtor's over-indebtedness.

8. Project Finance

8.1 Recent Project Finance Activity

Project finance continues to be of interest as a financing approach in Switzerland. There is, however, no specific trend currently in terms of industries that apply this method of finance.

8.2 Public-Private Partnership Transactions

Switzerland does not have specific federal or cantonal legislation dealing with public-private-partnership (PPP) transactions. The applicable rules therefore vary depending on the sector involved.

An important aspect of PPP transactions when these are structured within public procurement projects will be to abide by the rules for participation and awarding public projects. At the federal level, these rules are set out in the Federal Public Procurement Act (PPA) and, where the Swiss federal government is party to a project, the rules of the PPA must be complied with.

In addition, Switzerland is a signatory to the WTO Agreement on Government Procurement that applies to procurements by the Swiss Confederation and the cantons, as well as public

companies in the water, electricity and transport sectors.

The federal and cantonal bodies have implemented an electronic platform for public procurement purposes called "Simap". It offers a procedure for public contract-awarding authorities to post their tenders and any relevant tender documents. Bidders and interested companies are given an overview of all existing contracts across Switzerland and documents are freely accessible.

8.3 Governing Law

Depending on the sector of a project and its scope, relevant documents and information may need to be submitted to competent authorities for information or for approval. This will typically be the case in relation to construction, zoning and environmental issues and concessions.

8.4 Foreign Ownership

Jurisdiction over public sector projects is allocated between federal, cantonal and municipal authorities, depending upon the sector involved. At a federal level, the main responsible government body is the Department of the Environment, Transport, Energy and Communications (DETEC) and the agencies attached to it. The DETEC is in charge of transport, energy, communications, aviation and the environment.

The Federal Communications Commission is the regulatory body for the telecommunications sector. It is responsible for granting licences for the use of radio communication frequencies and promulgating access conditions when service providers fail to reach an agreement.

The Swiss Federal Electricity Commission is Switzerland's independent regulatory authority in the electricity sector. It monitors electricity prices as well as electricity supply security and regulates issues relating to international electricity transmission and trading. In Switzerland, cantonal and municipal bodies generally have authority over natural resources such as oil, gas and mineral resources.

With regard to state ownership in Switzerland, three central sectors used to be fully state-owned.

- Railways – the Swiss federal government is currently the sole shareholder of the Swiss Federal Railways, which used to be a government institution. Shareholder responsibilities of the federal government are performed by the General Secretariat of the DETEC in co-operation with the Federal Finance Administration.
- The postal service – Swiss Post is still entirely owned by the Swiss government as a public limited company.
- Telecommunications services – Swisscom (a telecommunications provider) is also a public limited company but its shares are listed on the SIX Swiss Exchange. Currently, the Swiss federal government holds the majority of the share capital and the voting rights.

8.5 Structuring Deals

The preferred legal form of a project company is the stock corporation. Sometimes, international holding structures are also used. Tax issues should always be considered when setting up the structure.

With regard to foreign investment issues, there are only a few restrictions, and non-discriminatory competition between foreign and domestic entities prevails. The main restriction occurs with respect to real estate property by application of the Lex Koller, which contains several

restrictions and authorisation requirements for the acquisition of non-commercial property by foreign or foreign-controlled investors (see **6.4 A Foreign Lender's Ability to Enforce Its Rights**). In this context, foreign investment in a project company holding non-commercial real estate may be restricted by the Lex Koller.

Switzerland has signed more than 120 bilateral investment promotion and protection agreements (BITs) with developing and emerging market countries around the world. BITs improve legal certainty and the investment climate. Switzerland has the world's third-largest network of such agreements after Germany and China.

The purpose of BITs is (i) to afford international law protection from non-commercial risks associated with investments made by Swiss nationals and Swiss-based companies in partner countries, and (ii), reciprocally, investments made by nationals and companies of partner countries in Switzerland. Such risks include state discrimination against foreign investors in favour of local ones, unlawful expropriation and unjustified restrictions on payments and capital flows.

The Swiss Constitution protects property rights. However, in order to achieve planning goals, the competent authorities may – subject to the rules of expropriation – dispossess land from private persons. Expropriations are permitted if they are:

- based on sufficient legal foundations;
- in the public interest;
- compliant with the principle of proportionality; and
- unable to be achieved by other reasonable means.

In addition, full compensation has to be made.

8.6 Common Financing Sources and Typical Structures

The typical funding techniques for project financings are debt financing (including financings covered by the export credit agency), mezzanine financing, capital markets and state subsidies. Switzerland has an official export credit agency, the Swiss Export Risk Insurance (SERV), which offers various insurance and guarantee products to cover political and credit risks. So far, SERV's products have primarily been relied upon for financings in the power, railways and mechanical engineering industries. That said, SMEs are increasingly relying on SERV's support, which contributes to expanding the scope of industries seeking out SERV's policies and commitments to facilitate financings.

8.7 Natural Resources

Under Swiss law, land ownership extends downwards into the ground to the extent determined by the owner's legitimate interest. Therefore, any natural resources found on a property belong to the owner of the property, with the exception of groundwater rivers.

However, mining rights and exploitation of natural resources – such as oil, gas or minerals – are usually regulated by federal or cantonal legislation, and a governmental permit, licence or concession is necessary. A concession will be granted in exchange for the payment of concession fees or royalties. The amount of concession fees typically depends upon the value of the concession. Domestic and foreign parties are treated equally in this regard. Export restrictions extend to nuclear energy, water for energy production, protected plants and animals.

8.8 Environmental, Health and Safety Laws

Switzerland has enacted various environmental, health and safety laws and regulations. Such rules do not generally impact upon the financing of projects. The main regulatory body at a federal level is the DETEC. In particular, the Federal Office for the Environment within the DETEC deals with issues relating to the environment and health and safety.

The main federal acts regarding the environment and health and safety are:

- the Federal Act on Protection Against Dangerous Substances and Preparations;
- the Federal Act on the Protection of the Environment;
- the Federal Act on the Protection of Waters;
- the Federal Act on Narcotics and Psychotropic Substances;
- the Federal Act on Radiological Protection;
- the Federal Act on Foodstuffs and Utility Articles; and
- the Federal Act on Protection Against Infectious Diseases in Humans.

Many secondary federal ordinances are also applicable in various areas, such as biodiversity, climate, contaminated sites, biotechnology and major accidents. In addition, cantonal or municipal legislation is abundant.

TAIWAN

Law and Practice

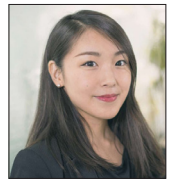
Contributed by:
Kunchou Tsai, Acacia (Hsiang-Hsien) Hsieh and Clare Chang
Enlighten Law Group

Contents

Enlighten Law Group handles cross-border and cutting-edge legal and financial issues, offering expertise in finance, banking, M&A, capital markets, arbitration and transnational matters. The firm strives to function as the interface between legal work, finance and technology, and is the first Taiwanese law firm to have spoken on the subjects of fintech and blockchain at the official conferences of the International Bar Association (IBA) and the Law Society of Hong Kong (HK Solicitor Association). The firm's partners and counsel are recognised by both the industry and clients for their considerable legal experience in their respective fields. The firm provides efficient and quality services in an innovative manner, especially in emerging and interdisciplinary areas, such as fintech, economic crime and forensic accounting. Its goal is to bring a brand new wave of expertise to Taiwan's legal service market and to provide appropriate, efficient and high-quality services for the various needs of its clients.

Authors

Kunchou Tsai specialises in fintech, financial regulations, corporate finance, capital markets, international investment and arbitration. He received his LLM degrees from the first-tier law schools at University College London and the University of California, Berkeley, and is well known for his achievement in financial investment dispute resolution, including complicated, high-risk derivative products. He actively participates in the fintech and Web 3.0 ecosystems, and often consults on cross-border investment and financial disputes. Since 2017, he has been appointed to the panel of arbitrators of the China International Economic and Trade Arbitration Commission (CIETAC), the Shanghai International Economic and Trade Arbitration Commission (SHIAC) and the Japan Commercial Arbitration Association (JCAA).



Acacia (Hsiang-Hsien) Hsieh is a solicitor qualified in England and Wales, who remains connected with the Taiwanese market and is an of counsel at Enlighten Law Group. She obtained a degree in BSc Economics from the London School of Economics and Political Science before practising law. Her experience in banking and finance focuses on advising Chinese institutional lenders and corporate borrowers on facility and security documentation for transactions, such as the participation of syndicated loans, receivable financing and mezzanine loan arrangements.

Clare Chang served as a member of the Law Committee of Personnel and Administration of the Taiwan Executive Yuan before she joined Enlighten Law Group. During her tenure as an attorney, she has actively participated in a wide array of legal matters. Her experience encompasses civil cases, including the recovery of compensation, personal data breach damage compensation, and labour dispute mediation. Clare has also handled criminal cases involving food safety laws, cross-strait relations regulations, sexual harassment, forgery, fraud and public insult. Her expertise extends to intellectual property cases, such as customs enforcement of trade mark rights and copyright infringement, as well as non-litigation matters like corporate recruitment planning and internal company investigations.

Enlighten Law Group

11th Floor
391 Xinyi Road
Section 4 Xinyi District
Taipei
Taiwan

Tel: +886 2 7728 7028
Email: contact@enlightenlaw.com
Web: www.enlightenlaw.com

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Due to multiple unfavourable factors, such as consecutive rises in interest rates by the US Federal Reserve, shrinking global end-use demand, and high manufacturing inventories, Taiwan's economic growth has been affected. In the economic forecast released by the Directorate General of Budget, Accounting and Statistics (DGBAS) in May 2023, Taiwan's GDP growth for the full year of 2023 was projected to be 2.04%. However, in August, this forecast was revised downward to 1.16%.

Impacted by concerns of economic recession, there has been an increased demand for financial borrowing. The flourishing development of fintech in Taiwan resulted in substantial growth in consumers' adoption of digital finance and a surge in both the number of retail credit loan applications and the loan values. According to the Joint Credit Information Center, by October 2022, the number of individuals applying for credit loans in Taiwan exceeded 1.58 million, reaching the highest record in history since 2012. The average value borrowed per person was nearly TWD643,000, also reaching an all-time high, with the aggregate credit balance nearing TWD1.02 trillion.

1.2 Impact of the Ukraine War

The Taiwanese financial market's overall risk exposure to Russia and Ukraine, as reported by the Financial Supervisory Commission (FSC) in March 2022, is approximately TWD217 billion, which is considered to be under manageable control.

The aggregate holdings of Russian and Ukrainian assets through mutual funds and overseas funds are both below 1% of their respective total, indicating limited financial risk exposure to the war.

Since the war began, the FSC has urged financial institutions and virtual asset service providers to implement anti-money laundering measures, to comply with international sanctions measures, and to be mindful of transactional risks. While Taiwan may not be directly affected by the war in Ukraine, these measures by the FSC still contribute to ensuring the stability of the financial system in Taiwan.

1.3 The High-Yield Market

In Taiwan, high-yield bond funds must either seek FSC permission or report to the FSC. Typically, such a review procedure takes between two and three months.

Taiwanese domestic investors have had a strong demand for high-yield bond funds in recent years due to low interest rates. To avoid a rapid increase in the number of high-yield bond funds, the FSC promulgated new rules addressing information disclosure and advertising requirements. In November 2021, the FSC announced four measures to strengthen the monitoring requirements of high-yield bond funds and fund risk disclosure:

- all "high-yield bond funds" must be renamed "non-investment grade bond funds" within six months to avoid investor confusion;
- financial institutions should improve fund risk disclosure and provide more risk assessment reference information;
- sales institutions should fortify their ability to assess the customer's fitness for funding; and
- investors are strongly encouraged to review the investment risk assessments included in the fund's prospectus before subscribing.

In addition, the FSC requires fund companies to adequately communicate the risks associated with investing in their high-yield bond funds by including warning labels in parenthesis after the fund name.

In March 2022, the FSC continued to push for fair and reasonable treatment for individual investors over 65 years of age in banking industries, encouraging the Bankers Association of the Republic of China to establish the Self-Regulatory Rules for Fair Treatment by Banks of Elderly Customers, so as to provide an increased variety of financial services to investors over 65. In April 2022, the FSC urged the Chinese National Futures Association to update relevant self-regulations to promote enhanced protection measures for individual investors over 65 in the securities and futures market, including KYC and KYP procedures, legibility of relevant documents, and transaction monitoring mechanisms. Overall, the applicable regulations governing high-yield bond funds have become more stringent, especially for individual investors over 65.

Lastly, in April 2022, the Insurance Bureau of the FSC announced that investment-linked insurance products will no longer be able to invest in high-yield bond funds as they are renamed as non-investment grade bond funds. This has been in effect since July 2023.

1.4 Alternative Credit Providers

In Taiwan, alternative credit provider financing has increased in popularity over the past few years. When collateral for a conventional bank loan is unavailable, small and mid-sized businesses typically seek other lending sources.

Business angel financing has grown in prominence as a source of early-stage capital for start-ups. The popularity of crowdfunding and peer-to-peer lending has also surged in recent years, but has remained relatively small in terms of total volume.

Insurance companies as well as bond (debt) funds also provide credit to corporate debtors as an alternative to a bank.

1.5 Banking and Finance Techniques

Taiwanese private borrowers typically issue convertible corporate bonds to reduce the risks investors are exposed to through equity investment. Upon borrowers satisfying certain pre-agreed milestones, lenders would typically have the option to convert their bond holding into preferred equity at a discount.

In an effort to encourage environmental sustainability and social responsibility, some public enterprises now issue FSC-approved sustainable bonds, offering investors more investment options:

- green bond – a bond whose proceeds are used exclusively for green projects;
- social bond – a bond whose proceeds are used exclusively for social projects;
- sustainability bond – a bond whose proceeds are used exclusively for a combination of both green projects and social projects; and
- sustainability-linked bond (SLB) – a bond for which the principal and interest payment terms are linked to the issuer's sustainability performance targets (SPTs).

As of August 2023, there have been 154 sustainable bonds issued, and the outstanding balance of issued bonds is TWD442.545 billion.

1.6 ESG/Sustainability-Linked Lending

The FSC approved the Green Finance Action Plan on 6 November 2017, in response to the

international trend toward green finance. The action plan covers areas such as credit, investment, fundraising in capital markets, training and talent development, data transparency, further expansion of green finance products and services, and dissemination of sustainable and environmentally friendly concepts.

Plan 1.0 was a tremendous success in the credit sectors, supporting green energy enterprises in gaining financing or investment. The outstanding loans supplied by domestic banks to green energy companies hit TWD1.41 trillion as of the end of March 2022, a rise of approximately TWD 429.6 billion since the commencement of Plan 1.0.

The FSC announced the "Green Finance Action Plan 2.0" in August 2020, which includes further steps to raise companies' awareness of ESG issues. One of Plan 2.0's primary objectives is to encourage financial institutions to finance and invest in sustainable development projects, as opposed to solely green energy industries, by easing lending and capital-raising laws and regulations.

In September 2022, the FSC rolled out the "Green Finance Action Plan 3.0", aiming to promote a sustainable taxonomy for companies and financial institutions to refer to when formulating transition plans and to incorporate into the process of making lending or financing decisions, so as to reach the 2050 Net-Zero Emissions policy.

2. Authorisation

2.1 Providing Financing to a Company

Providing loans to Taiwanese borrowers does not require a licence or other authorisation in Taiwan, so long as the lending activity does not involve deposits or foreign exchange business.

The Company Act places fundamental limitations on the ability of non-bank lenders to make loans to others. Pursuant to Article 15 of the Company Act, the parties to whom a company may lend its funds shall be limited to:

- any company having a business relationship with the company; or
- any company in need of funds for a short-term period, if the amount of the financing does not exceed 40% of the company's net worth.

Furthermore, if the lender is a public company, that company shall establish its internal procedures for lending funds to other parties, and those internal procedures shall be approved both by the board of directors as well as in the shareholders' meeting.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

In Taiwan, foreign lenders are not required to obtain a licence in order to extend credit to Taiwanese businesses. To operate a lending business, however, international lenders need to establish a branch office in Taiwan.

3.2 Restrictions on Foreign Lenders Receiving Security

There are no restrictions on granting security or guarantees to foreign lenders. For further information on the enforcement of security interests by foreign lenders, see **6.4 A Foreign Lender's Ability to Enforce Its Rights**.

3.3 Restrictions and Controls on Foreign Currency Exchange

Taiwan imposes no foreign exchange controls on trade, insurance or authorised investment transactions. Similarly, it does not restrict the repatriation of capital and profits related to direct or portfolio investment, provided that the investment has been permitted or approved by the Taiwan authorities.

3.4 Restrictions on the Borrower's Use of Proceeds

Generally, a borrower is obliged to use the proceeds from loans or debt instruments for the purpose expressly stated in the relevant credit agreement. If a borrower uses the proceeds of financing for any purpose other than what is specified in the credit agreement, this will constitute a default, and the lenders can accelerate any outstanding loans and terminate unused commitments. In addition, loan documentation prohibits borrowers from using the loan proceeds for any purpose that is in violation of anti-money laundering regulations.

3.5 Agent and Trust Concepts

The agent concept is well recognised and established in Taiwan. In a syndicated loan arrangement, the borrower usually grants a mandate to a "lead bank", which then arranges for the formation of a syndicate of banks to provide necessary finance to the borrower. The liability of the agent is usually limited by the underlying documentation appointing the agent.

The trust concept is generally recognised in Taiwan. The trust structure is often employed in real estate transactions, with real estate development trusts being the most popular. The landowner usually entrusts the land to the bank and deposits the funds into the trust account. All payments incurred by the construction project must be paid from the trust account until the construction is completed and the licence for use has been issued.

3.6 Loan Transfer Mechanisms

Typically, unless otherwise agreed upon by the lender and the borrower, or unless the nature of the claim is non-transferable, a loan can be transferred to the transferee without the borrower's consent. All the ancillary rights and securities attached to the claim are also transferred to the transferee.

However, the FSC imposes additional loan transfer restrictions on financial institutions. Specifically, transfers of performing loans and non-performing loans are governed by distinct rules.

3.7 Debt Buy-Back

Debt buy-back is generally permitted, except for any contractual restrictions. Bond buy-back may trigger the application of securities market regulations.

3.8 Public Acquisition Finance

The "certain funds" restrictions stipulated in Article 43-1, Paragraphs 3 and 4, of the Securities and Exchange Act and the Regulations Governing Public Tender Offers for Securities of Public Companies require bidders to produce documentation confirming their ability to finance their tender offer in full.

This requirement may be met by submitting either a letter of performance guarantee provided by a financial institution, or a cash confirmation provided by a financial adviser who is qualified as a securities underwriter or a certified public accountant.

In addition, the public acquisition rules require the board of directors of the target company

to conduct a more in-depth assessment of the sources of takeover financing and the fairness of the terms and conditions of the tender offer, in order to protect the interest of the shareholders.

A bidder must disclose details of the financing of a takeover bid in the offer document before it takes effect. These details include the source and availability of funds to pay the offer, payment methods and other payment arrangements. If the money is borrowed from a bank, the offer document must also include crucial loan details, such as the parties to the loan, principal amount, interest rate, tenor and security arrangement.

The Constitutional Court recently made a decision on the constitutional controversy surrounding the provisions related to public tender offer in the Securities and Exchange Act and the Regulations Governing Public Tender Offers for Securities of Public Companies.

Since Article 43-1, Paragraph 3, of the Securities and Exchange Act does not itself specify the exact proportion of shares that a bidder proposes to acquire in order to trigger a public tender offer, adopting what is known as a "blank criminal law" framework, one must refer to Article 11, Paragraph 1, of the Regulations Governing Public Tender Offers for Securities of Public Companies to ascertain. The applicant therefore argued that the interpretation of the terms in the above-mentioned articles violate the principle of clarity of punishment. Moreover, the provision regarding public tender offers in the Securities and Exchange Act is considered special criminal law, yet the act delegates the constituent element of "certain proportion" and "certain conditions" to the regulatory authority to mandate, which violates the principle of explicit delegation.

In judgment 112-Hsien-Pan-5 of the Constitutional Court of Taiwan, the court upheld the constitutionality of the above-mentioned regulations. Given that the bidders are regulated by these regulations and have professional expertise in matters of public tender offers, the content specified in the articles is not difficult for them to comprehend and can be anticipated. Therefore, the articles are in accordance with the principle of clarity of punishment. Besides, in response to the rapid changes in the securities market, the Securities and Exchange Act delegates the competent authority to mandate the details of certain proportions and certain conditions, since it possesses the most comprehensive knowledge of security market activities. Furthermore, the provisions of the Securities and Exchange Act are sufficient to enable individuals to foresee the possibility of violating mandatory provisions of public tender offers. Therefore, there is no violation of the principle of the explicit delegation.

3.9 Recent Legal and Commercial Developments

To assist businesses with achieving the government's 2050 Net-Zero Emissions policy, and prompt public companies to reduce carbon emissions, in 2022, the FSC amended both the Regulations Governing Information to be Published in Annual Reports of Public Companies and the Regulations Governing Information to be Published in Public Offering and Issuance Prospectuses.

These revisions stipulate that public companies should disclose their progress concerning climate-related activities within their annual reports, starting from the year 2024. Considering the promotion of climate-related information disclosure requires public companies to collect relevant information and develop greenhouse gas

inventory capabilities, there is a one-year grace period before the regulations enter into force.

3.10 Usury Laws

If the agreed rate of interest exceeds 16% per annum, the exceeded part of the agreement is invalid.

3.11 Disclosure Requirements

In order to eliminate contradicting information, Article 11 of the Regulations Governing Information to be Published in Public Tender Offer Prospectuses states that if the public tender offeror or any of its related parties have entered into any agreement or covenant concerning the present public tender offer with the director, supervisor or managerial officer of the subject company, or any shareholder owning more than a 10% stake in the subject company, or related parties of the target company, within the two years prior to declaring the public tender offer, the prospectus shall disclose all of the agreement or covenant documents.

4. Tax

4.1 Withholding Tax

Interest payments to non-resident lenders are subject to withholding tax at a rate of 15% or 20%, pursuant to Article 3 of the Standards of Withholding Rates for Various Incomes. This rate may be lowered by a tax treaty (generally to between 7% and 15%).

4.2 Other Taxes, Duties, Charges or Tax Considerations

Financial services providers (including non-resident lenders) offering loans to Taiwanese borrowers are subject to a 5% or 2% gross business receipts tax. The granting and enforcement of a loan, a guarantee or a security interest are not subject to any form of stamp tax.

Additional taxes and costs that may apply to a loan transaction include registration fees and court expenses associated with the introduction of the judicial enforcement of security interests.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

Foreign lenders who are either non-Taiwan residents or profit-seeking enterprises having no fixed places of business in Taiwan are subject to withholding tax, with an interest rate of 15% or 20%. However, Taiwan has signed double taxation agreements with 34 jurisdictions. The agreements mostly offer a preferential withholding rate of 10% or 15%, and foreign lenders are advised to review whether they are from these jurisdictions and then apply for a tax reduction, if applicable, so as to alleviate their tax burden and avoid double taxation.

5. Guarantees and Security

5.1 Assets and Forms of Security

Real Estate

In Taiwan, mortgages are the most prevalent form of real estate collateral. In order to construct and perfect a mortgage, the parties must execute a written agreement that establishes the security interest and record it in the land registry.

Movables

The perfection requirements on movables vary significantly depending on the type of security used. The creation and perfection requirements for a mortgage over movables are the same as those for a mortgage over real estate. A pledge over movables, to the contrary, does not need to be registered. A pledge is perfected when

the pledgee takes possession of the collateral. Given that the pledgee's possession or undue control of the movables may interrupt the business of the pledgor, a pledge over movables is usually undesirable for both parties. As a result, the use of a pledge over movables is uncommon in Taiwan.

Property Rights

A right of pledge can be used to obtain security over stock interests, receivables, deposits in bank accounts, and other property rights. Perfection requirements differ depending on the nature of the property rights. Typically, the creation of the right of pledge requires parties to enter into a written agreement and to deliver to the pledge creditor a certificate representing the pledged property rights.

5.2 Floating Charges and/or Similar Security Interests

A company's current and future assets are not subject to a floating charge or other universal or comparable security interest under Taiwanese law. A chattel mortgage can only be created over certain types of movable property, such as machinery, equipment, tools, raw materials, semi-finished products, finished products and vehicles. In other words, a security provider can only grant security over specific assets currently owned by that security provider, as the security provider does not yet hold a proprietary interest in the assets.

5.3 Downstream, Upstream and Cross-Stream Guarantees

There are no explicit statutory limitations or restrictions on downstream, upstream and cross-stream guarantees. However, the Taiwanese Companies Act imposes basic restrictions on the ability of a company to give a guarantee to a third party. In general, a company will not give any guarantee or security in connection with any loan, unless otherwise prescribed by law or set out in its articles of association. Furthermore, a public company may provide guarantees or security to the following firms:

- any company with which it has a business relationship;
- any company in which the public company, directly or indirectly, holds more than 50% of the voting shares; and
- any company that, both directly and indirectly, holds more than 50% of the voting shares in the public company.

Companies in which the public company holds, directly or indirectly, 90% or more of the voting shares may make guarantees for each other of up to 10% of the public company's net worth, provided that this restriction shall not apply to guarantees made between companies in which the public company holds, directly or indirectly, 100% of the voting shares.

From a formal perspective, the granting of a downstream, upstream or cross-stream guarantee will be approved by the board of directors of the public company acting as guarantor and will adhere to its internal rules of operational procedures for a guarantee, which are approved both by the board of directors and in the general meeting of shareholders.

5.4 Restrictions on the Target

When the target grants guarantees or other security interests in exchange for obligations of an acquirer, any such security interest would be upstream in nature and therefore subject to the limitations discussed in **5.3 Downstream, Upstream and Cross-Stream Guarantees**. Notably, the directors of the target will be exposed to the risk of breaching their fiduciary

duties if the target provides a guarantee solely for the benefit of an acquirer in the absence of its own corporate benefit.

5.5 Other Restrictions

There are several statutory constraints on the provision of security.

The creation of a security interest in certain assets is prohibited, including the right to reimbursement of healthcare costs, the right to claim for a pension and insurance claims arising under an insurance policy. Additionally, a company cannot lend money using its own shares as collateral.

5.6 Release of Typical Forms of Security

Security requiring registration shall be released by an application to the registrar jointly by the security provider and the creditor, or by the creditor alone. For unregistered security interests, the security is released by returning the relevant asset or notes to the pledgor.

5.7 Rules Governing the Priority of Competing Security Interests

Competing Security Interests

The general rule is that the precedence of competing security interests over an asset is determined by the order in which the security interests were perfected, with the earliest completed security having the highest priority. If the perfection requirements are not met, a security interest is not created, and those lenders will fall under the category of unsecured creditors.

Contractual Subordination

Regarding the ranking of security interests, contractual subordination can be created in many cases by changing the ranking and priority of repayment rights. In its simplest form, a subordination clause prevents the junior creditor from being paid until the senior creditor has been paid in full. In practice, the subordination clause is commonly used in the intercreditor agreement. Technically, a subordinated creditor would include all of the shareholders in the principal borrower, who usually agrees that creditors have priority over shareholders for claims on the company's assets.

5.8 Priming Liens

Mortgage of Real Property

The mortgagee has a preferential right to receive satisfaction of a claim from the proceeds from sale of real property without transferring possession. The enforcement of mortgaged real property is usually achieved through court proceedings. The mortgagee has to obtain the compulsory enforcement authorised by court to auction the mortgaged property. Alternatively, instead of engaging in court proceedings, the mortgagee can enter into a contract with the mortgagor to acquire ownership of the mortgaged property or dispose of it, after the debt is due.

Mortgage of Personal Property

If the debtor fails to perform the contract, the mortgagee may take possession of the personal property which is mortgaged and may sell the property without going through court proceedings, and satisfaction of the mortgagee's claims from the sale proceeds shall have precedence over other claims.

If the debtor or a third party refuses to deliver the mortgaged property, the mortgagee may petition a court for provisional attachment.

Pledge of Personal Property

A pledgee possesses the personal property transferred by a debtor or a third party as security for the claim. After receiving no payment upon maturity of the claim, the pledgor may sell

the pledged personal property by auction and receive payment preferentially from the proceeds of the sale.

Pledge of Rights

A pledge of rights is a pledge in which the subject is a transferable claim or other transferable right. For a pledged pecuniary claim with a maturity earlier than the claim it secures, the pledgee may demand the debtor lodge the payment for the pecuniary claim and may exercise its pledge against the thing lodged. Conversely, if the pledged pecuniary claim has a later maturity than the secured claim, the pledgee can demand payment at the maturity of the secured claim.

If the subject of a pledge is securities for which no rights holder is named, the pledgee may collect payments receivable on such securities even if the claim secured thereby has not matured.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

A lender's ability to enforce its security interest is contingent upon the secured debt remaining unpaid when due and payable. Loans, guarantees and other forms of security interests are typically enforced through judicial proceedings. The lender will usually petition the court for a judgment or payment order.

For joint suretyship, the lender can claim the guarantee in the event of a default. However, for a general guarantee, a guarantor may refuse performance to the creditor, as long as the creditor has not filed for compulsory execution against the property of the principal debtor.

For mortgage enforcement, the lender may claim to sell the collateral at the judicial auction process and be eligible for the proceeds. One of the problems with judicial enforcement is that the price is likely to be substantially lower than what would be realised through a private auction.

6.2 Foreign Law and Jurisdiction

In general, Taiwanese courts recognise the validity of a submission to a foreign jurisdiction.

Taiwanese courts typically recognise the legality of the parties' choice of a foreign law as a contract's governing law. However, the parties cannot choose the governing law of security interests. Rather, the property rights of an object are governed by the law of the jurisdiction in which the object is located.

6.3 Foreign Court Judgments

A final and binding judgment rendered by a foreign court is recognised by Taiwanese courts, except where:

- the foreign court lacks jurisdiction pursuant to the laws of Taiwan;
- a default judgment is rendered against the losing defendant, unless the notice or summons of the initiation of action had been legally served within a reasonable time in the foreign country or had been served through judicial assistance provided under Taiwanese law;
- the performance ordered by that judgment or its litigation procedure is contrary to Taiwanese public policy or morals; or
- there is no mutual recognition between the foreign country and Taiwan.

These provisions shall apply mutatis mutandis to a final and binding ruling rendered by a foreign court.

6.4 A Foreign Lender's Ability to Enforce Its Rights

There is currently no restriction on the ability of a foreign lender to enforce its rights under a loan or security agreement.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

According to Articles 74 and 82 of the Bankruptcy Act of Taiwan, lenders shall claim their right to the bankruptcy administrator. Under statutory insolvency proceedings, creditors of unsecured claims are generally prohibited from enforcing their loans once judicial insolvency proceedings have been initiated against the borrower.

Instead of general proceedings, unsecured creditors must recover their claims in accordance with the insolvency procedure, in terms of both the timing and the amount of the recovery. The same holds true for the enforcement of a guarantee in the event of the guarantor's insolvency.

7.2 Waterfall of Payments

As the purpose of bankruptcy proceedings is to provide equitable satisfaction to creditors, in principle there is no difference in the order of creditors' rights. However, the law gives some precedence. The Labour Standards Act, for instance, gives priority to the settlement of outstanding wages, stating that unpaid wages and labour unions have priority to be reimbursed when a debtor declares bankruptcy.

In addition, if there is a mortgage or guarantee, the mortgage or guarantee can be executed and has priority over the collateral.

7.3 Length of Insolvency Process and Recoveries

The length of insolvency processes differs on a case-by-case basis, depending on the debtor's specific circumstances. While the liquidators shall complete the examination within a period of six months, it takes at least three to six months.

Under a bankruptcy proceeding, the assets of a company are usually disposed of by the trustee appointed by the court. The debts and administrative expenses in connection with the estate must be paid out first. Creditors secured by means of a pledge, mortgage or lien before the adjudication of bankruptcy can enforce their rights over the collateral without going through the bankruptcy proceeding. If the debts and expenses incurred in the bankruptcy proceeding exceed the value of the estate, however, the bankruptcy proceeding will be terminated, and the company must enter into a dissolution proceeding.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Along with judicial insolvency proceedings, private restructuring processes are very important. Private restructuring processes can be initiated by:

- shareholders who have been holding shares representing 10% or more of the total number of issued shares continuously for a period of six months or longer;
- creditors of the company who have claims equivalent to 10% or more of the capital from the total number of issued shares;
- labour unions; or
- two thirds or more of the employees of a company.

Corporate reorganisation is the process of restructuring a financially distressed public company. The purpose of the system is to preserve and rehabilitate the company under the supervision of the court to adjust the interests of creditors, shareholders and other stakeholders.

7.5 Risk Areas for Lenders

According to the Bankruptcy Act of Taiwan, a bankrupt is not permitted to dispose of any property. Therefore, a third party can only claim their rights against a bankrupt's accountant during bankruptcy proceedings. Furthermore, when a party is adjudicated as bankrupt, all proceedings involving the bankruptcy estate are stayed automatically until a qualified person assumes the action, pursuant to the Bankruptcy Act, or until the bankruptcy proceeding is concluded. However, the mortgagee and secured parties have unrestricted rights to the collateral.

8. Project Finance

8.1 Recent Project Finance Activity

Due to the international trend of green finance, green energy projects, especially solar and wind farms, have been one of the main topics for project finance in Taiwan recently. In the National Development Plan (2021-2024), the green and renewable energy sector is listed as one of six core strategic industries that Taiwan plans to develop.

The completion of Formosa 1, Taiwan's first offshore wind farm, was a momentous moment for green energy projects in the country. Subsequent projects include the Formosa 2, Yunlin, Changfang and Xidao, Greater Changhua, Zhong Neng, Foxwell and Hai Long offshore wind farms.

With the focus on green energy, Taiwan aims to be a nuclear-free area by 2025.

8.2 Public-Private Partnership Transactions

In order to relieve the government's financial burden, there is a trend in Taiwan of co-operation between the public and private sectors to build public infrastructure; this type of co-operation is known as a public-private partnerships (PPP). There are numerous laws governing private participation in infrastructure projects, including:

- the Statute for Promotion of Private Participation in Transportation Infrastructure Projects;
- the Mass Rapid Transit Act;
- the National Property Act;
- the Local Government Public Property Administration Act;
- the Commercial Port Law;
- the Electricity Act; and
- the Act for Promotion of Private Participation in Infrastructure Projects (PPIP Act), which is the most important.

Pursuant to Article 8 of the PPIP Act, there are six types of private participation, as follows.

Build–Operate–Transfer (BOT)

The private institution invests in the construction and operation of new infrastructure and, upon the expiry of the operation period, transfers the ownership of such infrastructure to the government.

Build-Transfer-Operate (BTO)

The private entity invests in the construction of the infrastructure and, upon completion of the construction, relinquishes the ownership to the government without compensation; the government then lets the private entity operate the infrastructure. Upon the expiry of the operation

period, the right to operate reverts to the government.

Alternatively, the private entity invests in the construction of the infrastructure. Upon completion of the construction, the government acquires the ownership by paying the construction expenses, in a lump sum or in instalments. The government then lets the private entity operate the infrastructure. Upon the expiry of the operation period, the right to operate reverts to the government.

Rehabilitate-Operate-Transfer (ROT)

The private institution invests in the extension, reconstruction and/or repair of existing infrastructure, and operates the infrastructure. Upon the expiry of the operation period, the right to operate reverts to the government.

Operate-Transfer (OT)

The private institution operates infrastructure built with investment from the government. Upon the expiry of the operation period, the right to operate reverts to the government.

Build-Own-Operate (BOO)

To support national policy, the private institution invests in the construction of infrastructure on private land provided by the private institution itself, has the ownership thereof upon completion of the construction, and then the operates the infrastructure itself or commissions a third party to operate it.

Foreign investor and Mainland China investors are welcome to join a PPP, although some limitations are imposed by applicable laws and regulations to safeguard national security, including:

- the Statute for Investment by Foreign Nationals;
- the Statute for Investment by Overseas Chinese;
- the Act Governing Relations between the People of the Taiwan Area and the Mainland Area; and
- the Negative List for Investment by Overseas Chinese and Foreign Nationals.

Foreign investors and Mainland China investors should comply with these laws and regulations.

8.3 Governing Law

Investment agreements, offtake contracts, financing agreements, project insurance policies and land acquisition agreements are governed by domestic law.

Parties to a contract are generally free to choose the governing law of the contract. It is common practice for the parties to select the law of Taiwan, Singapore, New York or England as the governing law for projects in Taiwan. However, government entities involved in investment agreements under the PPP Act typically do not accept foreign law as the governing law.

8.4 Foreign Ownership

Foreign entities may not acquire forest lands, fisheries, hunting grounds, salt fields, land with mineral deposits, or sources of water and water rights. Apart from these restrictions, foreign entities with a branch in Taiwan, whose home countries entitle Taiwanese nationals to the same rights, may acquire land in Taiwan.

8.5 Structuring Deals

Project finance is a loan arrangement whereby finance is raised on a non-recourse or limited recourse basis by a special purpose vehicle (SPV), with the repayment being contingent on the cash flows generated by the project after its completion.

Parties in project financing deals typically face the same issues when structuring the deals. These issues may need to be viewed from a different perspective, taking into account the project's potential extension. A comprehensive risk analysis will be conducted and the various risks, once identified, should be appropriately allocated in the transaction documents to the parties best positioned to bear such risks.

Banks may also want to have a clear understanding of the future cash flows and profit model of the project, in order to decide whether to implement additional protections such as credit enhancement tools and security. In practice, a traditional security package remains a crucial factor in project finance loan decisions. In addition to sufficient equity financing, banks typically require pledges on all relevant project assets and cash flows, the SPV's bank accounts, and also the shares in the SPV itself.

Restrictions on Foreign Investment and Any Relevant Treaties

In contrast to its open and welcoming attitude towards foreign investment, the Taiwanese government takes a prudent and conservative attitude towards Chinese and Hong Kong investment. Foreign investors are normally permitted to invest in a project firm so long as their investment does not involve industries on the "negative list", which is a list of sectors where foreign investment is limited or forbidden. In contrast, Chinese investors are only allowed to invest in the permitted industry sectors on the "positive list". Even if the sector that the Chinese investor intends to invest in is on the positive list, the Investment Commission has the discretion to restrict or block a Chinese investment application due to national security concerns.

8.6 Common Financing Sources and Typical Structures

The typical financing sources for projects in Taiwan include domestic and foreign commercial lenders (including institutional investors such as insurance companies), government support such as funds from the National Development Council and the National Development Fund, international institutions such as the Asian Development Bank, and, to a lesser extent, project bond investors and export credit agencies.

Typically, a project company in Taiwan is an SPV organised as a limited liability corporation with a limited recourse financial structure. Equity is normally provided by a single sponsor or a consortium of sponsors. Projects may be purely private (such as independent power projects) or may involve a partnership between the public and private sectors.

8.7 Natural Resources

All natural resources related to mining, including oil, gas, coal, metal and other mineral resources, are owned by the state (Article 2 of the Mining Act). However, an entity can still explore, extract and exploit these natural resources by applying for mining rights. Article 15 of the Mining Act establishes the procedure for businesses to apply for mining rights. In general, such rights are valid for a period of 4 or 20 years after approval by the government, and enterprises can apply for an extension before expiry.

Exporters must comply with the Foreign Trade Act and the Regulations Governing Import of Commodities while exporting natural resources; this legislation is administered by the Bureau of Foreign Trade (BOFT). In addition, since the Taiwanese government adopts a highly regulated policy in the field of energy affairs, the exportation of oil (petroleum products) is subject to strict

control. Pursuant to Article 15 of the Petroleum Administration Act, a business is not allowed to start an oil export operation until its application has been approved and a registration certificate has been issued by the Bureau of Energy.

It should be noted that some natural resources are on the "Sensitive Commodities List", such as nickel, chromium and titanium. Enterprises cannot export these natural resources to Iran or North Korea until they obtain approvals from the BOFT.

8.8 Environmental, Health and Safety Laws

Taiwan has enacted a number of environmental protection laws, such as:

- the Air Pollution Control Act;
- the Water Pollution Control Act;
- the Soil and Groundwater Pollution Remediation Act;
- the Waste Disposal Act; and
- the Toxic and Concerned Chemical Substances Control Act.

These laws are implemented and enforced by the Environmental Protection Administration. Businesses investing in Taiwan must comply with these laws, otherwise they may attract civil, administrative or criminal liabilities.

Additionally, in September 2022, the FSC rolled out the Green Finance Action Plan 3.0, aiming to enhance understanding of greenhouse gas emissions by financial institutions, in order to reduce carbon emissions and to achieve the 2050 Net-Zero Emissions policy.

The plan contains five main aspects, the summaries of which follow:

- deployment – the financial industries are required to propose the time schedule for the disclosure and inventory of green gas emissions, and to develop monitoring mechanisms for climate risks and file analysis reports for climate-related risk management;
- funding – the FSC aims to develop and promote Taiwan's sustainable taxonomy (and encourage companies to disclose their compliance with the taxonomy in terms of their economic activities), and formulate self-governing regulations for financial institutions as a reference for investment or financing assessments on financial products which adopt concepts such as "green", "ESG" or "sustainability";
- data – government agencies plan to build up and promote a data platform integrating climate change and ESG-related information and data for use by financial institutions;
- empowerment – the FSC plans to strengthen sustainable finance training for managers and regular employees of financial institutions, and to introduce sustainable finance certificates; and
- ecosystem – the FSC plans to organise a sustainable finance evaluation to establish the financial industry's net-zero working group and foster co-operation between financial institutions.

By 2023, 22 financial institutions in Taiwan have signed the Equator Principles, so it may be difficult for enterprises with poor records of compliance with environmental laws to obtain loans or acquire project finance.

The Occupational Safety and Health Act and the Labour Occupational Accident Insurance

and Protection Act are the two main health and safety acts, with both being enforced by the Department of Labour. Under the Occupational Safety and Health Act, employers are obliged to prevent occupational accidents and to maintain sound and safe working environments, or they may attract legal liabilities. The Occupational Safety and Health Act and the Labour Occupational Accident Insurance and Protection Act consolidate occupational accident claims under various statutes into a single remedial appeal, allowing the insured to file a claim more easily and with a clearer legal standing.

According to the Act for Promotion of Private Participation in Infrastructure Projects, enforced by the Ministry of Finance, an authority in charge shall conduct a feasibility assessment before promoting the projects. Experts, scholars, local residents and civil groups shall be invited to public hearings. If the authority does not adopt the suggestions given or oppositions raised by the experts, scholars, local residents or civil groups, it shall state the reasons for this in its feasibility assessment report.

THAILAND

Law and Practice

Contributed by:
Jessada Sawatdipong, Sarunporn Chaianant, Supawich Nimmansomboon and Supawin Pongthananikorn
Chandler MHM Limited

Contents

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Chandler MHM Limited is a leading Thai law firm committed to achieving an international standard of practice for the company's international clients. The firm has a total of 100 lawyers and 80 non-legal professionals, with 20 of the firm's lawyers, including six partners, in its banking and finance practice group. This group has advised on some of Thailand's and neighbouring countries' most complex and high-value financings. The practice has significant experience acting for both lenders and borrowers on a wide range of financing transactions, including major power, infrastructure, and real estate projects. It continues to focus on major cross-border transactions, supported by MHM's offices across Asia, such as in China, Indonesia (ATD Law in association with Mori Hamada & Matsumoto), Japan, Myanmar, Singapore and Vietnam. The practice maintains long-standing relationships with all major commercial banks in Thailand as well as with well-known international financial institutions.

Authors

Jessada Sawatdipong is a senior partner at Chandler MHM Limited (CMHM). He specialises in banking and finance, particularly project finance, with a focus on major, cross-border energy and natural resources, infrastructure and real estate projects. Aside from having extensive experience with all major Thai commercial banks, he has also worked with leading international banks and multinational financial institutions. He represents both lenders and borrowers and has an extensive list of Thai banks on his books. A member of the Lawyers Council of Thailand, he is also an ordinary member of the Thai Bar Association, 1984, as well as a member of the International Bar Association (IBA) and the Inter-Pacific Bar Association (IPBA).

Sarunporn Chaianant is a counsel at Chandler MHM Limited (CMHM). She specialises in banking and finance with a focus on project financing in the energy, infrastructure and real estate sectors. Her experience includes representing Thai and foreign financial institutions and project companies/sponsors in a number of domestic and cross-border financing transactions. In addition, she has been involved in mergers and acquisitions transactions and has advised clients in various industries on general business practices. She holds a licence to practise law from the Lawyers Council of Thailand and is an ordinary member of the Thai Bar Association of 2013.

Contributed by: Jessada Sawatdipong, Sarunporn Chaianant, Supawich Nimmansomboon and Supawin Pongthananikorn, **Chandler MHM Limited**

Supawich Nimmansomboon is an associate at Chandler MHM Limited (CMHM) in the banking and finance practice group. He is experienced in providing advice on a wide range of legal areas, including banking, finance, aviation, general corporate and business. Supawich's experience includes acting for both lenders and borrowers on renewable energy projects and on various cross-border financing transactions. In addition to holding a permanent licence to practise law from the Lawyers Council of Thailand, he is also an ordinary member of the Thai Bar Association.

Supawin Pongthananikorn is an associate at Chandler MHM Limited (CMHM) in the banking and finance practice group, specialising in a diverse range of legal areas. His expertise spans mergers and acquisitions, project finance and corporate finance transactions. He advises on regulatory, compliance, corporate, commercial and ESG-related matters for clients. He has been engaged in legal research on various topics as well as matters involving due diligence and contract review in the real estate, energy, and industrial sectors.

Chandler MHM Limited

17th and 36th Floors
Sathorn Square Office Tower
98 North Sathorn Road
Silom
Bangrak
Bangkok 10500

Tel: +66 2009 5000
Fax: +66 2009 5080
Email: cmhm_info@mhm-global.com
Web: www.chandlermhm.com

CHANDLER MHM

Contributed by: Jessada Sawatdipong, Sarunporn Chaianant, Supawich Nimmansomboon and Supawin Pongthananikorn, **Chandler MHM Limited**

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Despite the impact of the COVID-19 pandemic, higher energy prices, global inflation and weak export markets, Thailand's economy has recovered steadily supported by government initiatives. Having learnt from previous financial crises (including the Tom Yum Kung crisis) Thailand's banking system remains resilient, with high capital funds, loan loss provisions and liquidity. Lending standards for businesses and consumers are generally stringent, particularly when the risk of default increases.

In August 2023, the Monetary Policy Committee decided to increase policy interest rates from 2.00% to 2.25% per annum, which is in line with other countries. Higher interest rates are in part intended to reduce inflationary pressures and address the accumulation of financial imbalances caused by prolonged low interest rates (introduced following the 2007–2008 global financial crisis).

Over the past few years, the economy has been weaker than usual, which has impacted the ability of SMEs and households to manage their debt repayments and to secure new financing. Household debt has reached 90.6% of the country's gross domestic product, which is historically high. Household debts are escalating due to rising interest rates. There has been an overall fall in demand for loans, particularly hire-purchase loans for automobiles.

1.2 Impact of the Ukraine War

The global impact of the Ukraine war has resulted in higher energy costs and, consequently, higher inflation. This is combined with strong demand for goods and services following the pandemic when supply chains were still recovering. Central banks around the world, including the Bank of Thailand (BOT), have responded to this crisis by increasing interest rates to decrease overall demand in the economy as well as potential inflation.

Thailand has experienced the highest inflation rate in 24 years since the Tom Yum Kung crisis. In the third quarter of 2023, Thailand's inflation reached 7.3%, resulting in an average inflation rate of 6.1% for the year 2022. Despite the above, due to the generally conservative and stringent approach to lending, Thai banks' non-performing loans are not as high as expected (2.67% of outstanding loans as of June 2023). However, the higher costs combined with higher interest rates are impacting the ability of all sectors to maintain their current financial commitments and obtain new financing.

The ability of the new Thai Government to provide financial support will be limited by rising borrowing costs. In light of weak economic growth, high inflation and higher interest rates, financial institutions will be particularly cautious in their approach to lending. Corporates with strong balance sheets such as in the energy sector will be able to attract finance whereas SMEs in the export market will face more stringent lending conditions.

1.3 The High-Yield Market

The issuance of high-yield bonds has remained stable since 2021, the value of which accounts for 4% of the overall value of bonds in the Thai bond market. Issuers tend to be concentrated in the capital and securities, energy, utilities, and real estate development sectors. Recently, the issuance of high-yield bonds would typically involve the provision of more collateral to raise the confidence of investors. At least 70%

of high-yield bonds are secured either by corporate guarantees or fixed assets such as land and buildings.

In 2023, the high-yield bonds market has experienced multiple cases of maturity extensions resulting from the inability to roll over existing bonds. A significant portion of these bonds, around 63%, belong to the real estate development sector. Moreover, the recent incident involving a major property developer in Thailand defaulting on interest payments for their bonds has raised concerns among investors. These concerns are not limited to unrated or non-investment-grade bonds; they are now also affecting investment-grade bonds.

1.4 Alternative Credit Providers

Traditional financial institutions, such as commercial banks and specialised financial institutions, continue to be the major credit providers in Thailand, especially when it comes to financing large corporate transactions. Non-banks and start-ups have become more prominent in the market for typical loans to individuals such as personal loans and nano-finance. By having a more approachable method for accessing loans with a less complicated process, such alternative credit providers can be a more convenient option for individuals and retail customers.

1.5 Banking and Finance Techniques

Digital Factoring Ecosystem

In the past, SMEs were generally unable to access factoring transactions because factoring business operators were concerned about the unreliability of invoices submitted by customers and their requests for double financing on the basis of the same invoices. Using central web services (CWS) technology, the BOT launched a platform for digital factoring. By using the central database of the platform, it is possible to verify the invoices of customers in order to prevent double financing issues. In recent months, the platform has built confidence among factoring business operators, and more have agreed to enter into factoring transactions, which makes factoring a more readily accessible means of obtaining funding for SMEs.

Peer-to-Peer Lending

Lending by an individual or a juristic entity to an individual can be done on a licensed peer-to-peer (P2P) lending electronic platform. The platform operator will act as an intermediary by matching lending and borrowing activities and arranging the execution of loan agreements. Furthermore, the platform operator will have to assess the borrower's creditworthiness and client suitability, as well as procure the funds through a custodian or an escrow account.

This method of lending excludes administrative costs that normal financial institutions have to bear, and the platform operator will be able to eliminate significant costs normally charged to the borrower for similar services. Using this financing technique not only allows the borrower to access funds via a simpler and faster method, but also offers investors an alternative way to manage excess funds in addition to saving.

Digital Lending

Digital lending is a financing technique that allows licensed personal loan business operators to employ digital technology and alternative data as part of their credit risk analysis. It helps customers who may not have regular income or sufficient assets to serve as collateral for a loan but may have other online information that proves their ability to repay a loan to access a source of funds. Business operators are urged to proceed with the borrowing and repayment processes through an electronic platform such

as wire transfer or electronic money to create a digital footprint that will be useful for the customers when it comes to future financial products and services.

Crowdfunding

Crowdfunding, either by way of equity or debt, can be performed through a licensed funding portal. A borrower or an issuer will have to submit a business plan to the funding portal, which conducts a screening process and discloses relevant information online. Investors will then consider the published information and if they decide to make an investment to such business, they will pay a subscription fee that will be held by an escrow agent. The borrower will then issue shares or debentures to investors and will be required to provide periodic updates on the progress of the business.

Holding Company

A holding company normally engages in generating income through equity ownership in other companies without engaging in its own operational activities. This arrangement establishes legal separation between the operating company's assets and its owners, decreasing the owners' liability in case the operating company faces financial difficulties. Holding company (HoldCo) financing involves the offering of loans to a holding company positioned above an operating company. This would typically be an arrangement used in infrastructure and energy project financing, particularly where holding companies have more than one project.

1.6 ESG/Sustainability-Linked Lending

Financial regulators, including the Fiscal Policy Office, the BOT, the Securities and Exchange Commission, the Office of Insurance Commission, and the Stock Exchange of Thailand have established a Working Group on Sustainable Finance to promote sustainable finance and to support the Thai economy in achieving sustainable development goals.

The BOT, the Thai Banker Association and 15 commercial banks have jointly signed a Memorandum of Understanding setting forth responsible lending guidelines for each commercial bank in order to promote sustainability within the banking sector and the national economy. A strong commitment to responsible lending, stakeholder engagement considerations, internal implementation mechanisms, and transparency are the four pillars of the responsible lending guidelines.

The BOT and the Securities Exchange Commission have jointly developed Thailand Taxonomy, which is a reference tool for classification of economic activities deemed environmentally sustainable. Different classifications of each activity will be subject to different level of compliance. Taxonomy Phase I focuses on energy and transportation sectors, whereas Phase II focuses on manufacturing, agriculture, real estate, construction and waste management sectors.

Financial institutions are increasingly integrating sustainability (environmental, social and governance) into their businesses and embedding it into their core strategies. Currently, the BOT is encouraging the financial sector to move towards environmental sustainability by creating appropriate incentives to support businesses in transitioning towards sustainable models.

2. Authorisation

2.1 Providing Financing to a Company

Licensed commercial banks (Thai commercial banks, subsidiaries of foreign commercial banks

and branches of foreign commercial banks) are authorised to provide financing to companies. In the case of non-banks, specific types of financing, eg, personal loans, nano-finance for occupational purposes and provincial retail loans (pico finance) are regulated and subject to licensing requirements. Licence applications can be submitted to the BOT or the Ministry of Finance for consideration and approval. Non-banks who conduct business that is not regulated, and who are foreigners under the Foreign Business Operation Act, are also required to obtain a foreign business licence.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

In general, foreign lenders are not restricted from providing loans to Thai residents, except in the case when the loans are provided to individuals and can be classified as personal loans, nano loans or pico loans. In such cases, loans from foreign lenders are subject to the BOT's regulations.

3.2 Restrictions on Foreign Lenders Receiving Security

There are no substantial restrictions on the provision of security or guarantees to foreign lenders, except for a provision of security under the Business Security Act B.E. 2558 (2015) to a foreign lender. In these cases, a foreign lender that is a commercial bank is required to grant a loan in syndication with Thai banks to be eligible to have security under this law, see **6.1 Enforcement of Collateral by Secured Lenders**.

3.3 Restrictions and Controls on Foreign Currency Exchange

The purchase and remittance of foreign exchange are subject to the approval of authorised agents, usually commercial banks, for all bona fide transactions that do not fall into the restricted purposes outlined under the Exchange Control Act, B.E. 2485 (1942), as amended.

If a transaction falls within such restricted purposes, specific approval from the BOT must be obtained. In any case, the remittance and payment made under a loan, guarantee, or any other associated interest or fees are not categorised as restricted purposes; therefore, a specific approval from the BOT is not required.

While the BOT's approvals are granted on a case-by-case basis, such approvals have been routinely granted for all bona fide transactions, provided that the relevant supporting documents/agreements to prove a legitimate commercial purpose are submitted to the BOT together with other supporting documents, as required by the BOT.

3.4 Restrictions on the Borrower's Use of Proceeds

There are no general laws imposing a restriction on the borrower's use of proceeds from loans or any debt securities. Nevertheless, a borrower is prohibited from using the proceeds in connection with illegal activities.

In most loan agreements, the purposes of the loan proceeds are specified and any deviation from such purposes would constitute a default, giving the lender the right to terminate the loan agreement.

3.5 Agent and Trust Concepts

Generally, the creation of a trust by a will or by a juristic act is prohibited under Section 1686 of the Thai Civil and Commercial Code. However, a trust can be established for purposes of securities, securitisation, and capital market transactions under the Trust for Transaction in Capital Markets Act B.E. 2550 (2007). Accordingly, the concept of a trust established for general purposes is not recognised under Thai law and the obligations of a person to hold anything in trust for any other person may not be enforceable, although analogous rights are recognised in certain transactions.

However, such unenforceability would not in itself affect the recognition of the validity of the particular transaction to which the person acting as trustee was a party.

Notwithstanding the above, an appointment of an agent is commonplace in financing transactions in Thailand and a concept of principal-agent relationship is recognised under Thai law. In a syndicated loan, lenders usually appoint a security agent among themselves to hold security for and on behalf of a lender. There is no specific licensing requirement for acting as a security agent. However, mortgage registration does not allow the concept of a security agent, thus each lender must enter into a mortgage agreement as a mortgagee.

3.6 Loan Transfer Mechanisms

Assignment

A loan transfer by way of assignment of rights is usually made when loan disbursements have already been made in full and no commitments are available under the loan agreement. As a result, only the right to receive loan repayments will be transferred.

An assignment of rights of the existing lender to the new lender must be made in writing. For an assignment to be valid against the borrower, a written notice must be given, or written consent must be obtained from the borrower. Following the assignment, the rights over the mortgage, pledge and business security agreement existing on the loan and the rights arising from a guarantee established for the loan are automatically transferred to the new lender, provided that the transfer of the mortgage and business security agreement is registered with the appropriate authorities. Nevertheless, the security interest over an assignment of rights under the project agreements, insurances, etc, which is not considered preferential rights under the law, will not be automatically assigned upon the assignment of the loan. Therefore, such assignments must be executed between the new lender and the borrower to ensure their validity.

Although a guarantee or any security interests created by a third party will be automatically assigned to the new lender, it is advisable that the notice of assignment is delivered to the relevant guarantor and a third-party security provider to ensure that the assignment is duly acknowledged.

Novation

Where the loan has not been fully disbursed, an assignment of the loan may not be a viable option since the assignment only transfers the rights of the original lender to the new lender but not the obligations. In this situation, a novation should be executed to ensure that the new lender remains liable for any further disbursements of the loan.

A transfer of rights and obligations of the existing lender to the new lender may be executed by way of novation where a form of tripartite agree-

ment is required to be entered into among the existing lender, the new lender and the borrower. Additionally, the parties may agree to transfer the security granted to the existing lender under the existing loan agreement to the new lender, provided that, if the security is provided by a third party, consent from such third party is obtained.

A loan participation, where the existing lender wholly or partially sell its interests in a loan to another lender, is also a viable option for a transfer of the loan, provided that the commercial bank assigns the loan to a financial institution that meets the requirements set out by the BOT.

3.7 Debt Buy-Back

Under Thai law, debt buy-backs by the borrower result in the loan's rights and obligations being vested in the same entity, and the loan will be extinguished. Even though the rights and obligations under the loan can be merged within the same entity, debt buy-back arrangements are not commonly used in Thailand. Often, lenders and borrowers will enter into discussions to restructure and reduce the amount of debt to be repaid by the borrower should there be a situation where the borrower is unable to pay the debt in full.

For a debt buy-back by a third party – ie, a sponsor, there is no specific law or regulation explicitly prohibiting the sponsor from buying back the borrower's debts. Sponsors are legally permitted to repay the loan to the lenders (or purchase debt or claim rights against the borrower) and then subrogate the lenders' rights as creditors. However, loan agreements can specify that the transferee of the lender must appear on an approved list of banks, thus making the debt buy-back infeasible for the sponsor.

3.8 Public Acquisition Finance

In public acquisition transactions, if an acquiror wishes to acquire shares of a target company that reach certain thresholds as specified by law, the acquiror must make a tender offer for all the issued shares of the target company. The offeror is required to indicate the source of funding in its tender offer documents as a method of demonstrating its ability to fund the tender. If the source of funds includes funds secured by debt financing from a financial institution, a commitment letter issued by the financial institution must be submitted as a supporting document along with the tender offer documents, which are to be publicly filed with the Securities and Exchange Commission.

There is no specific requirement for details or minimum particulars in such commitment letter; however, in practice, commitment amounts and an effective period for such commitment are specified. Loan agreements for certain funds can be executed thereafter with certain condition precedent documents set forth by the lenders that are sometimes subject to lenders' satisfaction.

3.9 Recent Legal and Commercial Developments

Replacement of Interest Rates

As a consequence of the London Interbank Offered Rate (LIBOR) cessation on 30 June 2023, a number of loan agreements in the Thai market have been amended to replace the existing IBOR reference rates with the new interest rate. In the past, one of the most commonly used reference rates for floating rate products in Thailand was the Thai Baht Interest Fixing (THBFIX) which comprises LIBOR as a key element for calculation. New interest rates vary among each of the loan agreements. Common new rates include Secured Overnight Financing Rate (SOFR) and

Thai Overnight Repurchase Rate (THOR) (for a loan agreement that originally used LIBOR and THBFIX as a reference rate, respectively).

Default Interest

Recently, the Thai Civil and Commercial Code has been amended to provide that where monetary obligations are due in instalments, the default interest rate shall be calculated on the due but unpaid principal amount of such default instalment. Usually, loan agreements are normally drafted in a way that the default interest is charged on the unpaid amount. Such provision would thus have to be amended so that the basis of calculation of the default interest is on the due and unpaid amount.

Order of Application of Proceeds

In late 2020, the BOT announced a regulation in relation to the order of application of proceeds when lenders receive payments from borrowers and such payments cannot satisfy the entire outstanding amount under the loan agreements. Under the BOT Notification, repayment for loans structured with instalment repayments or revolving credit extended to customers by financial institutions regulated by BOT must be applied towards applicable fees, default interest and the principal amount of the amount outstanding respectively. If the debt is due on an instalment basis, the proceeds must be applied towards the outstanding amount of each instalment based on the respective order above, from the furthest overdue instalment to the nearest.

3.10 Usury Laws

The interest rate charged on a loan shall not exceed 15% per year in general. According to the BOT's Notification on practices regarding interests, discounts, service charges, and penalties for commercial banks, each commercial bank is entitled to announce its own maximum interest rate to be charged to its customers for Thai baht commercial loans above a cap of 15% per annum. The charging of interest on a foreign loan provided by banks or financial institutions registered and located in foreign countries is limited to 20% per annum.

Fees, penalties and other payments under a loan agreement which are in the nature of interest may be regarded as additional interest. If interest is charged at a rate in excess of the applicable ceiling, the entire interest charged may be held to be void and unenforceable.

Default Interest

The default interest rate can be agreed at a higher rate than that of the loan interest rate. However, the Thai courts can classify exorbitant default interest rates as penalties. The courts can use their discretion to reduce the default interest rate if they take the view that such default interest rate is disproportionately high.

In addition, the newly amended Thai Civil and Commercial Code prescribes that where debts are due in instalments, the default interest rate shall be calculated on the due but unpaid principal amount of such default instalment. Thus, default interest can be charged only on the principal amount of each instalment.

Under the Thai Civil and Commercial Code, interest on interest can be charged after it is overdue for more than one year, provided that the lender and the borrower have agreed in writing in advance, and that the entire debt shall be charged interest at a specified rate. In respect of financial institutions and non-banks under supervision of the BOT, in 2022, the BOT issued a notification regarding practices for calculation of interest for entities under its supervision meaning that, except for certain transactions,

they may not accumulate the interest, service charges, penalties, and expenses to a loan's outstanding balance to recalculate the interest and penalties.

3.11 Disclosure Requirements

Related-Party Transactions

Under the Securities and Exchange Commission Act B.E. 2535 (1992) and relevant Securities and Exchange Commission (SEC) regulations, listed companies may enter into certain transactions with a related party upon approval by the board of directors or the shareholders, as the case may be. Disclosure of such a transaction must be made to the Stock Exchange of Thailand. A financial contract that may fall within the scope of such related-party transaction (RPT) may include, among others, a guarantee agreement where a listed company agrees to guarantee the indebtedness of its affiliates or vice versa. In any case, disclosure is only required when the transaction value reaches the applicable threshold when compared to the net tangible assets of the relevant listed company as specified in relevant SEC regulations.

Where a disclosure is required to be made, the details below in relation to the agreement must be provided to the Stock Exchange of Thailand:

- date and relevant parties to the agreement;
- general explanation regarding the nature of the offer or receipt of financial assistance relating to the decision to enter into the transaction; and
- the total value and criteria used in determining the transaction's total value.

It is important to note that the disclosure requirement is not applicable where the listed company holds at least 90% of the total share capital of the affiliate.

Reporting Obligations in Relation to Anti-Money Laundering Laws

Under the Anti-Money Laundering Act B.E. 2542 (1999), Thai financial institutions are required to report to the Anti-Money Laundering Office (AMLO) a transaction which involves real property and machinery worth more than THB5,000,000. In respect of project financing transactions, execution of mortgage agreements (land/building/machinery) is usually required to be reported to the AMLO, since the mortgage amount or transaction value would typically be the amount of the loan facility which would be higher than THB5,000,000.

Upon entering into a mortgage agreement, financial institutions, which include commercial banks, finance companies, securities companies, insurance companies and other business related to finance, are required to report to the AMLO the following information:

- transaction type;
- date and relevant parties to the agreement;
- details of the property; and
- value of the transaction (mortgage amount).

4. Tax

4.1 Withholding Tax

Interest, other fees, expenses, charges, penalties, and other payments made to an offshore lender are generally subject to withholding tax of 15%. However, the withholding tax may be reduced or waived by virtue of a tax treaty between Thailand and the resident country of the relevant lender.

4.2 Other Taxes, Duties, Charges or Tax Considerations

The payment of stamp duty on the following financing documents is a condition of entry into civil proceedings before the Thai courts:

- Loan agreements: stamp duty of THB1 for every THB2,000 or a fraction thereof of the total amount of the loan, but not exceeding THB10,000.
- Guarantee agreements: stamp duty of THB10 of the total guaranteed amount exceeding THB10,000.
- Pledge agreements: stamp duty of THB1 for every THB2,000 or a fraction thereof of the total amount of the loan, without limitation (note that if the loan agreement, which is a principal obligation, has been affixed with stamp duties, the relevant pledge agreements are not required to be affixed with the stamp duty).
- Nominal duty on duplicates of dutiable instruments.

Stamp duties are required to be affixed within 30 days of bringing the document into Thailand if it is signed abroad, or within 15 days if it is signed in Thailand, otherwise penalties will be applied for the late stamping. Furthermore, a dutiable instrument without a stamp cannot be admitted as evidence in Thai courts.

Additionally, the following fees apply to the registration of certain securities under Thai law with the relevant government body:

- mortgage registration for land and/or building mortgage – 1% of the mortgage amount but not exceeding THB200,000;
- machinery mortgage registration – THB1 per THB1,000 of the mortgage amount but not exceeding THB120,000; and
- business security agreement registration – 0.1% of secured amount but not exceeding THB1,000, except for registration of security over land where the fee shall be equivalent to the land mortgage registration fee.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

There are generally no other tax concerns for foreign lenders apart from withholding tax, as mentioned in **4.1 Withholding Tax**.

It should be noted that the tax treatment does not differ between money centre banks and non-money centre banks or any foreign financial institutional lenders under the Revenue Code. However, certain international financial organisations such as the World Bank, International Finance Corporation (IFC) and Asian Development Bank (ADB) are not subject to withholding tax liabilities on interest, other fees, expenses, charges, penalties, and other payments. This is provided that in such particular transactions, the relevant international financial organisations do not operate in a commercial setting or with the purpose of seeking benefit in Thailand.

5. Guarantees and Security

5.1 Assets and Forms of Security

In Thailand, assets that can be provided as collateral are generally real estate, movable property, shares and claims. Security executed not in accordance with the formalities and perfection requirements may be considered invalid, void, or unenforceable, as the case may be.

Real Estate

A typical form of security interest over land and/or buildings is a mortgage. A mortgage agreement must be registered with the competent offi-

cial at the relevant land offices where such land/building is situated, otherwise the mortgage is invalid. As mentioned in **3.5 Agent and Trust Concepts**, since Thai law does not recognise the concept of trust, the mortgage agreement must be entered into between the mortgagor and the lenders or secured parties as mortgagees and not by a security trustee, to ensure each lender's preferential rights.

It is important to note that Thai law prohibits a third-party mortgagor from being liable for the remaining balance of a secured obligation when the mortgage is enforced should the proceeds from enforcement not cover the amount due. Additionally, Thai law also prohibits a third-party mortgagor from acting as a guarantor while acting as a mortgagor for the same underlying obligation.

Movable Properties

Pledges and business security agreements over property are the most common form of security over movable property. Pledges require the actual delivery of the pledged property to the pledgee, and if the property is returned to the pledgor for any reason, the pledge is legally extinguished.

The Business Security Act allows the creation of security for movable property without the physical delivery of such assets to the security receiver. A Business Security Agreement (BSA) must be made in writing and registered via an online system with the Secured Transactions Registry Division. Due to this special feature of no actual delivery requirement, the use of the BSA over property prevails over the use of pledge of property in corporate loans.

Under the Business Security Act, the security receiver must be a financial institution, or any other person as prescribed under relevant Ministerial Regulations, which includes a foreign commercial bank that provides facilities in syndication with a financial institution as defined in the Financial Institutions Businesses Act B.E. 2551 (2008) – eg, Thai commercial banks. A foreign commercial bank that intends to be a security receiver must serve written notice of its intention to be a security receiver under the Business Security Act to the Department of Business Development, Ministry of Commerce with supporting documents proving that it is a commercial bank under the relevant laws in the jurisdiction of its registration/incorporation.

Shares

Shares are considered rights represented in an instrument and can be secured as collateral by way of a pledge. When pledging shares in a company, in addition to the physical delivery of the share certificates to the pledgee, a record of the pledge along with the name and address of a pledgee must be registered in the share register book of the company to ensure the pledge is valid against the company and third party.

Claims and Other Assets

Certain claims such as deposits in bank accounts, rights to receive proceeds, rights under agreements or intellectual property can be provided as collateral under the BSA.

In a project finance transaction, it is also common practice for a borrower to agree in advance to conditionally assign its rights under project-related contracts, rights to receive proceeds under insurance policies, etc, for the purpose of providing collateral to secure loan obligations in favour of a lender. However, the assignee will not be considered a secured creditor in bankruptcy proceedings.

An assignment of a right is not valid unless it is made in writing, and such assignment can be set up against the debtor or third persons if written notice thereof has been given to the debtor, or if the debtor has consented in writing to the assignment.

Rights Over Leasehold Assets

The Rights over Leasehold Asset Act B.E. 2562 (2019) introduced a new type of legal interest over land and/or buildings that is capable of mortgage registration, namely, the right over a leasehold asset (*Sap-Ing-Sith*). Rights over a leasehold asset are similar to leasehold rights whereby the owner of an immovable property registers with the relevant land office a right over a leasehold asset or the right to use the immovable property in favour of another person (the "Leasehold Right Holder"). The maximum duration for the registered right over a leasehold asset is 30 years. Rights over a leasehold asset can only be registered over land represented by a title deed, land with buildings constructed on land represented by a title deed, and condominium units under the Condominium Act B.E. 2522 (1979).

Traditionally, a person who could be a mortgagor in relation to real estate was limited to the owner of the land and/or building. However, pursuant to the Rights over Leasehold Asset Act, a Leasehold Right Holder is able to mortgage its rights over the immovable property that has been registered as a right over a leasehold asset.

Note that, in contrast to the limitation of a foreigner to hold ownership of land, a foreigner is allowed to be a Leasehold Right Holder and can subsequently mortgage such right in favour of the mortgagee.

5.2 Floating Charges and/or Similar Security Interests

There is no concept of a floating charge in Thailand, but the closest available option of security is business security which can cover the present and future assets of the security provider without requiring it to deliver any of its assets to the security receiver.

Business security can be created over a whole business.

However, the key difference between floating charges and security over the whole business under the Business Security Act is the Thai legal requirement to register all assets secured under a BSA over the whole business and the requirement to notify the security receiver of any changes in details of the secured assets.

Contrary to the floating charge concept where a specification of a class of asset charged to the chargee is required only once, and re-registration for future assets acquired by the chargor or assets disposed of in the ordinary course of business is not required, the Business Security Act requires that security providers notify the security receiver when they acquire new assets so that the registration of the security can be amended.

Nevertheless, a party may agree to set a threshold of changes that require notification, for example, the duty to notify will apply only if inventory increases or decreases by 20%. As a result of this stringent requirement and the uncertainty of enforcement, to date, a BSA over a whole business has rarely been used in Thailand, especially in relation to large commercial loans or project financing transactions.

5.3 Downstream, Upstream and Cross-Stream Guarantees

There is no restriction in giving downstream, upstream and cross-stream guarantees under Thai law, and the arrangement can be structured to allow one company to secure another company's debt. A guarantee provided by publicly listed companies or their subsidiaries to secure the debt of another company that shares the same controlling shareholder(s) or person(s) with management power is considered a related-party transaction that may require approval from the board of directors or shareholders, and may be subject to reporting requirements (depending on the size of the transaction).

5.4 Restrictions on the Target

There are no specific restrictions on the target to grant guarantees, security or financial assistance for the acquisition of its own shares. However, if the provision of a guarantee, security or financial assistance by the target for the acquisition of target's shares is considered a related-party transaction, certain requirements must be met as outlined in **5.3 Downstream, Upstream and Cross-Stream Guarantees**.

5.5 Other Restrictions

Requirement of a Licence

A foreign entity (which includes a Thai-incorporated entity of which its shareholding structure is majority or wholly owned by a foreign entity) is considered a "foreigner" under the Foreign Business Operation Act B.E. 2542 (1999), and that foreign entity is restricted from providing guarantees or any security to secure a third party's debts since provisions of a guarantee or security to secure a third party's debt are considered as provision of services under Annex 3 of the Foreign Business Operation Act. In such cases, a foreigner is required to obtain a foreign business operation licence before providing a guarantee or any form of security in Thailand. A foreign business licence is to be granted for each transaction individually, and the foreigner is required to apply for the licence each time it is required to provide security or a guarantee.

Thai Guarantee Law Limitations

As a result of the amendment to the Thai Civil and Commercial Code, the Thai guarantee law imposes certain limitations on the provision of guarantees, such as:

- an individual guarantor is prohibited from the provision of guarantees as a primary debtor;
- in the event of an extension of time granted by the creditor to the debtor for the secured obligation, the guarantor's obligation shall be extinguished, unless the guarantor consents to such extension of time at the time or after such extension;
- in the event that the creditor reduces the amount of the secured obligation, interest, compensation, or any other charges and if the payment after deduction has been made either by the debtor and/or the guarantor, the guarantor shall be free from the guarantee; and
- when a debtor defaults, the creditor must deliver a written notice to the guarantor within 60 days from the date that the debtor defaults. If the creditor fails to do so, the guarantor is released from interests, compensation and any other charges relating to such obligation after such 60-day period has ended.

Any provision in the guarantee agreement contrary to the guarantee law limitations will be rendered void and unenforceable.

5.6 Release of Typical Forms of Security

A full repayment of a secured obligation (a loan) will legally extinguish all ancillary obligations or security agreements related to such secured obligation.

If the security is registered with a competent official – ie, security created under a mortgage and BSA, the registration of release shall be made to reflect the actual extinguishment of the underlying loan agreement. For other types of security, a notice of release is usually served to the relevant obligors, and, in case of a pledge, the pledged property shall be returned to the pledgor.

5.7 Rules Governing the Priority of Competing Security Interests

With respect to security which requires registration (ie, a mortgage and BSA), the security interest that was registered the earliest has priority over interests registered later. Assets subject to a mortgage can subsequently be collateralised under the BSA and vice versa. However, an asset subject to collateral under the BSA cannot subsequently be pledged, otherwise the pledge will be invalid.

In bankruptcy proceedings, under Section 96 (1) of the Bankruptcy Act B.E. 2485 (1942), a secured creditor who has preferential rights over an asset may waive its priority by agreeing to relinquish such asset given as security for the benefit of all creditors and may apply for repayment of the debt in full. Nevertheless, it is uncertain whether the secured creditor can contractually waive its preferential rights over the secured assets prior to bankruptcy proceedings.

With respect to unsecured debt, contractual and structural subordination are feasible in Thailand. In bankruptcy proceedings, a contractual subordination provision is recognised under Section 130 bis of the Bankruptcy Act and, as a result, the subordinated debt shall be payable after all other unsecured debts are repaid in full.

5.8 Priming Liens

There is no concept of priming liens in Thailand. In general, security interest duly created in favour of a lender will give such lender preferential rights over other creditors which cannot be primed by any other lenders. Where the security is created in favour of multiple lenders, the security interest would rank according to the time of registration as mentioned in **5.7 Rules Governing the Priority of Competing Security Interests**.

However, rights to enforce the security of a secured creditor may be subject to the right of retention of other creditors. A right of retention allows a person who possesses another's property to retain it until an obligation relating to the property is performed. The right may be exercised against the whole of the property until the obligation is completely fulfilled. Certain conditions must be satisfied for the right to arise:

- there must be an obligation owed to the possessor by the borrower or the property owner which has become due;
- in the case of insolvency of the borrower or the property owner, the right may be exercised even if the debt has not become due;
- the obligation must arise in relation to the property itself; and
- the possession must have commenced lawfully.

As a result, a person who has the right of retention is legally entitled to withhold the secured property and may not be required to deliver such property to the secured creditor until the obligations owed to them by the borrower or the

property owner are duly performed. In any case, a person who has the right of retention is not entitled to enforce the property and apply the proceeds toward the performance of the borrower's or the property owner's obligation in the same manner that a mortgagee, a pledgee or secured creditors may have.

Further, in respect of real property, where a debtor owes any of the following duly registered obligations, a creditor of such obligations shall have preferential rights over the mortgagee:

- preservation of real property; or
- hire of work in relation to property situated on real property.

In other words, a creditor of debt obligations in relation to the abovementioned transactions owed by the landowner, shall have priority over a mortgagee of the same land.

In addition, in rehabilitation proceedings, a lender who has provided financial support to the borrower, during the period when the borrower was undergoing rehabilitation proceedings, is not required to submit an application for debt repayment under the rehabilitation proceedings and shall not be subject to the repayment terms under the rehabilitation plan (not subject to any debt hair-cut). Instead, such lender may enforce its loan in accordance with relevant terms in the financing documents, subject to automatic stay, or moratorium. Although new lenders may have priority over other unsecured creditors who have applied for debt repayment, the security interest provided in favour of existing creditors cannot be prejudiced in any manner.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Normally, collateral enforcement is triggered by an event of default under the relevant loan agreement.

Security enforcement typically involves the following methods:

- public auction through legal procedures with a court order;
- out-of-court public auction; and
- foreclosure.

When enforcing a mortgage or BSA, public auctions through legal procedures with a court order are usually required, except when the mortgagor or the security provider consents to the enforcement of the secured asset; in this case, an out-of-court public auction may be conducted.

For enforcement of a pledge, the pledgee may enforce the pledged property by a public auction without court procedures.

The foreclosure of secured assets is a viable option; however, it is uncommon in practice due to the requirement that the debtor have outstanding interest payments for at least five years and that the value of the secured asset not exceed the outstanding unpaid debt. If there is an agreement in advance allowing the lender to dispose of secured assets contrary to the foregoing, for example, a private execution agreement, such an agreement is invalid.

Under a BSA, there are also special provisions for the enforcement of deposit claims and security over the whole business. Whenever the security receiver of a deposit claim is a financial

institution, the enforcement procedures can be carried out immediately through direct settlement for those deposits, followed by a subsequent notice (without obtaining consent) to the security provider. For the whole business collateral, a third-party security enforcer appointed in advance by the parties will be responsible for enforcing and disposing of the whole business.

6.2 Foreign Law and Jurisdiction

The choice of foreign law agreed upon by the parties as the governing law of the loan will be recognised and applied by Thai courts, but only to the extent that such law is proven to the satisfaction of a Thai court (satisfaction is within the discretion of the court) and it is not considered contrary to Thailand's public order or good morals by the court. The scope of a court's discretion on public order or good morals has not yet been definitively established.

A provision that allows the courts of a foreign jurisdiction to have exclusive jurisdiction to settle any dispute may not be enforceable in Thailand. However, Thai law is silent on the effect of irrevocable submission to the jurisdiction of a foreign court, waivers concerning objection to venue, or the appointment of agents for service of process for the purposes of proceedings before such courts. There is no precedent case under Thai law ruling such submission, waiver or appointment invalid.

An express waiver of sovereign immunity made in writing may be effective in Thailand.

6.3 Foreign Court Judgments

A judgment of a foreign court will not be enforced by the Thai courts but may, at the sole discretion of the Thai courts, be admissible as evidence in an action in the Thai courts.

An award rendered by an arbitral tribunal is recognised and enforceable in a Thai court under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the Thai Arbitration Act B.E. 2545 (2002). Arbitral awards are enforced by Thai courts upon due application of a party seeking to enforce the award. Generally, Thai courts will not reexamine the merits of the dispute since they have already been examined and decided on by the arbitration tribunal. However, a Thai court may refuse to recognise and enforce an arbitral award based on several grounds as prescribed in Section 40 of the Thai Arbitration Act, for example, if the court views that the arbitral award is contrary to Thai law, public order or good morals.

6.4 A Foreign Lender's Ability to Enforce Its Rights

Due to Thai laws generally prohibiting foreigners from owning title to lands, there are very few exceptions where foreign lenders can enforce security over land by foreclosure. However, there are no restrictions that could affect a foreign lender's ability to enforce its rights under a loan or security agreement.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

Bankruptcy Proceedings

Under bankruptcy proceedings, upon a receivership order, an unsecured creditor will be prohibited from enforcing any of its rights in respect of claims against an insolvent debtor outside of the insolvency proceedings and shall submit an application for repayment in order to be repaid.

A secured creditor may opt to enforce its security outside of bankruptcy proceedings. However, if the proceeds from enforcement of secured

property do not cover the whole amount of debt, the secured creditor will not be able to apply for the repayment of debt in respect of the outstanding amount. A secured creditor may also choose to file an application for repayment. In such case, the secured creditor will be entitled to any debt shortfall after enforcement of the secured property.

Rehabilitation Proceedings

When the bankruptcy court accepts the petition for rehabilitation proceedings, an automatic stay, or moratorium, is levied to protect the debtor against actions by creditors such as litigation, enforcement of security and bankruptcy proceedings. As such, secured creditors would be unable to enforce their security outside the rehabilitation proceedings, unless otherwise approved by the bankruptcy court.

Creditors whose rights are restricted by the moratorium may submit a request to the bankruptcy court for an order to amend, modify or annul the limitations on their rights on the grounds that the restrictions are not necessary for the rehabilitation proceedings or that they do not sufficiently protect secured creditors' rights.

7.2 Waterfall of Payments

In the context of a corporate debtor's bankruptcy, Section 130 of the Bankruptcy Act outlines a specific hierarchy for the payment of debts, as follows:

- expenses incurred by the official receiver in the management of the debtor's property;
- fees for the collection of property;
- fees incurred by the plaintiff creditor as well as lawyers' fees as determined by the court or the receiver;
- taxes and duties due within six months prior to the receivership order and money which employees are entitled to receive prior to the receivership order in return for the service performed for the employer debtor;
- other debts; and
- subordinated debts.

In instances where there is insufficient money to fully satisfy the debts within a given tier, a pro-rata distribution will be made among the creditors in that tier.

The secured creditors will have preferential rights over their secured assets as mentioned in **7.1 Impact of Insolvency Processes**. Any debt shortfall after enforcement of the secured assets will be classified as other debts.

7.3 Length of Insolvency Process and Recoveries

The period of insolvency proceedings in Thailand typically depends on many factors. If the bankrupt entity has no assets, when such entity is declared bankrupt the bankruptcy process would take approximately one year from the initiation of the bankruptcy proceedings until the bankruptcy court orders the case to be closed.

On the other hand, if the bankrupt entity holds assets, when such entity is declared bankrupt creditors may notify and request the official receiver to confiscate the debtor's assets and proceed to sell those assets at public auction. The period of insolvency, where the debtor has assets, depends on the number of assets held by the debtor and whether each of the assets is successfully sold at auction. If the assets were not sold at auction, the auction process will be reinitiated, with the assets being discounted each time, until the assets are sold. The period when the auction takes place also depends on the number of auction cases. Typically, the auction occurs once every three to four months. As

a result, an insolvency process where the debtor has assets may take three years or more after bankruptcy proceedings have been initiated.

The recovery rates for unsecured creditors in Thai insolvency proceedings are varied. Given that secured creditors typically have the right to enforce their security over the debtor's assets first, what remains for distribution among unsecured creditors is often limited. Consequently, the recovery rates for unsecured creditors are generally minimal.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Commencement of Business Rehabilitation

Business rehabilitation procedures outside of insolvency proceedings are available in Thailand. Either the debtor or the creditor has the right to submit to the court a petition for a business rehabilitation. If it appears that a debtor is insolvent or unable to pay its debt, is indebted to one or more creditors for a definite amount of not less than THB10 million, regardless of whether such debt is due immediately or not, and there are reasonable prospects of rehabilitating the debtor's business, the court will usually accept the petition for rehabilitation proceedings.

Application for Repayment

As soon as the court issues an order to initiate the rehabilitation proceedings and appoints the planner (nominated by the one who filed the rehabilitation petition or by the creditors), all creditors (including foreign creditors) are required to file debt repayment applications, together with all supporting documents, against the debtor with the official receiver within one month from the date on which the order appointing the planner is published in the government gazette. A failure to file a claim by the end of such period (which is not extendable and no exceptions are provided for foreign creditors) will result in the creditor forfeiting its claim against the debtor.

Business Rehabilitation Plan

After the plan has been prepared by the planner, a creditors meeting must be held for approval of the plan. The proposed plan must be approved by either:

- creditors holding at least two-thirds of the outstanding debt value and more than half of the number of the total creditors from each class of creditors; or
- creditors holding two-thirds of the outstanding debt value and more than half of the number of the total creditors from at least one class of creditor, and creditors holding 50% of the outstanding debt value of all classes of creditors.

Upon approval of the plan by the creditors and the court, the plan will be considered to be binding on all creditors who submitted an application for repayment, whether voting for or against the plan or absent during the voting. If creditors have not filed an application for repayment of debt, these creditors will forfeit their rights to repayment unless the rehabilitation plan states otherwise, or the court cancels the order for business rehabilitation.

In any case, the creditors will always have the right to claim the full amount of debt from any guarantor, joint debtor or third-party security provider, since they are not bound by the rehabilitation plan.

7.5 Risk Areas for Lenders

The major risks to lenders when obligors become insolvent are the risks of the financing transaction or any related action thereof being subject to revocation under undue preference provisions

pursuant to the Bankruptcy Act and the Thai Civil and Commercial Code.

In a case where it appears that the borrower, security provider or guarantor becomes insolvent and is subject to bankruptcy proceedings, other creditors or the official receiver may be entitled to ask the court to cancel any payment made or provision of any security by the borrower, the security provider, or the guarantor to the lender with knowledge that it would prejudice other creditors. There is a legal presumption that if the payment or the provision of security is made during a period of one year before the initiation of the bankruptcy proceedings and thereafter, the borrower, the security provider, or the guarantor and the lender knew that such action would be prejudicial to the other creditor(s).

In addition, in the bankruptcy proceedings of the borrower or security provider, the court has the power, upon the application of the official receiver, to order the cancellation of the transfer of property or any act carried out by the borrower or security provider, or carried outwith the borrower's or the security provider's consent, three months before the bankruptcy petition or thereafter with the intent to give any creditor an advantage over other creditors.

8. Project Finance

8.1 Recent Project Finance Activity

Project financing structures in Thailand are commonly used for power plants, large-scale infrastructure projects, oil and gas and mining projects. Project financing structures are in fact usually found in the energy sector and power plant projects.

Following various government policies supporting renewable energy projects, in 2022, the Energy Regulatory Commission of Thailand (ERC) announced that it would purchase power from four types of renewable energy projects, namely biogas, wind, ground-mounted solar and ground-mounted solar with a Battery Energy Storage System (BESS). The total purchasing target is 5,203 MW. Furthermore, the ERC is currently considering purchasing 3,668 MW of additional renewable energy. We anticipate that the majority of these renewable projects will be structured using project financing as the financing method.

8.2 Public-Private Partnership Transactions

The Public-Private Partnership Act B.E. 2562 (2019) came into force in March 2019. The Act streamlines the process of investment partnerships between the public and private sectors. It is applicable to various types of projects, ranging from infrastructure transportation to public services, energy, telecommunications, hospitals, schools and exhibition centres.

In 2018, the Eastern Special Development Zone Act, B.E. 2561 (2018) was enacted. This Act creates an expedited process for the approval of public-private partnership projects within the so-called Eastern Seaboard.

Apart from the Eastern Seaboard initiative, under the Public Private Partnership Project Preparation Plans 2020-2027 (PPP Plans), there are 127 PPP projects in the pipeline with investment costs of over THB1.16 trillion to be executed within an announced timeframe.

8.3 Governing Law

There are no legal requirements that any of the project documents be governed by Thai law. The

parties can agree to project documents being governed by a foreign law, including English and New York law, and disputes may be resolved in any foreign courts or by international arbitration.

In all circumstances, if a governmental authority is a party to the project documents, it is generally necessary for the project documents to adhere to standard terms/templates with Thai law being the governing law, and disputes resolved by the Thai courts. For example, where an offtaker of power projects is a state-owned Thai electricity utility enterprise or where an owner of project land is a governmental authority, the power purchase agreement and land lease agreement would typically need to be drawn up in accordance with standard terms, allowing only limited room for negotiation, with Thai law stipulated as the governing law, and disputes resolved solely by the Thai courts.

8.4 Foreign Ownership

Under Thai law, foreigners are generally prohibited from owning real property, both surface and subsurface including any water resource which is represented by a title deed. Consequently, foreign lenders may not be able to foreclose on real property secured in favour of them following an enforcement event. Exceptions may apply, such as where land has been acquired under Board of Investment incentives or in respect of condominium units.

Given this drawback, in the case of syndicated financings, foreign lenders normally rely on separate security-sharing arrangements whereby proceeds from the enforcement of real property will be shared among all lenders on a pro-rata basis based on each lender's outstanding commitment.

With respect to water rights, there are no restrictions on foreigners applying for use of water resources, unless the water resource is located on private land where ownership is subject to foreign ownership restrictions. There is no private ownership of public water resources and the use of such water is subject to the relevant official's permission.

It is important to note that where security is created over shares, if the foreign pledgee opts to foreclose on the pledged shares, such foreclosure will result in the borrower becoming a foreign entity (majority-owned by a foreigner). Consequently, such entity may not be able to carry on its business if its business operation is considered a restricted business for a foreigner, unless a foreign business license is obtained. See **5.5 Other Restrictions**. Similarly, where a security is created over a ship and the foreign mortgagor forecloses on the mortgaged ship, the ship will need to be deregistered and exit Thai waters.

8.5 Structuring Deals

In structuring deals, several types of risk need to be carefully considered by lenders and their advisers. To ensure lenders' protection, specific issues relating to cashflow projections, project operations, and the identities of relevant counterparties should be taken into account.

The project company is usually a limited liability company newly set up as an SPV for the construction and operation of a project. Certain businesses, such as service businesses, are prohibited from being operated by a company wholly or majority owned by foreigners, except when a business licence is issued to allow the operation of such foreign businesses.

8.6 Common Financing Sources and Typical Structures

Bank loans are a major source of project financing in Thailand. The structure of the financing can be either bilateral or syndicated financing, depending on the risk exposure of each project. Lenders normally require capital contribution commitments by the project's sponsors up to a certain ratio without any or only limited recourse. Security packages range from security over fixed assets to mere contractual rights of the project owner under project-related agreements. Export and import credit financing is used to support the export of products and services from Thailand as well as the import of overseas products and services into Thailand. Forms of financing include a letter of credit, packing credit, trust receipt, shipping guarantee, etc.

Issuance of bonds is another common way for companies to raise funds for investments in projects. There has been an increase in the issuance of green bonds, social bonds, and sustainability bonds in the Thai bond market. These bonds are intended for investment or refinancing of loans for projects that are environmentally friendly, with the objective of promoting social and sustainability purposes. Nowadays, sustainability-linked bonds are more prevalent where issuers set a sustainability performance target whereby interest payment of the bonds will tie with their or their subsidiary's performance in achieving such target.

8.7 Natural Resources

While there is no particular legislation dealing with ownership of natural resources in Thailand, under the Thai constitution, the state possesses the power to manage, utilise, organise, use, and safeguard natural resources. Since regulations concerning natural resources vary by type of natural resource, should a person aim to obtain the rights to any particular natural resource, they must comply with the relevant laws enacted for that resource. Regarding beneficiation, there are no regulatory requirements that restrict the beneficiation of minerals in Thailand before export.

8.8 Environmental, Health and Safety Laws

The Office of Natural Resources and Environmental Policy and Planning Environment is the main regulatory body that imposes a requirement to conduct an Environmental Impact Assessment or an Environmental Health Impact Assessment for certain types of projects under the Enhancement and Conservation of National Environmental Quality Act B.E. 2535 (1992).

The Department of Industrial Works oversees various environmental, health and safety issues such as electrical system safety, chemical and radioactive safety, workplace safety, fire hazard safety and general management for air and water pollution, as well as the submission of Environmental Safety Assessments in accordance with the Factory Act B.E. 2535 (1992).

In addition to the two major regulators, there are various governmental agencies responsible for environmental, public health and safety issues, including:

- the Hazardous Substance Control Bureau, which is responsible for the management of hazardous substances, namely, oil, gas and fuel;
- the Department of Energy Business, which is responsible for the operation and construction of large oil storage facilities;
- the local authorities, which are responsible for construction and public safety; and
- the Department of Health, which is responsible for general public sanitation.

Trends and Developments

Contributed by:
Jessada Sawatdipong, Sarunporn Chaianant, Supawich Nimmansomboon and Supawin Pongthananikorn
Chandler MHM Limited

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Authors

Jessada Sawatdipong is a senior partner at Chandler MHM Limited (CMHM). He specialises in banking and finance, particularly project finance, with a focus on major, cross-border energy and natural resources, infrastructure and real estate projects. Aside from having extensive experience with all major Thai commercial banks, he has also worked with leading international banks and multinational financial institutions. He represents both lenders and borrowers and has an extensive list of Thai banks on his books. A member of the Lawyers Council of Thailand, he is also an ordinary member of the Thai Bar Association, 1984, as well as a member of the International Bar Association (IBA) and the Inter-Pacific Bar Association (IPBA).

Sarunporn Chaianant is a counsel at Chandler MHM Limited (CMHM). She specialises in banking and finance with a focus on project financing in the energy, infrastructure and real estate sectors. Her experience includes representing Thai and foreign financial institutions and project companies/sponsors in a number of domestic and cross-border financing transactions. In addition, she has been involved in mergers and acquisitions transactions and has advised clients in various industries on general business practices. She holds a licence to practise law from the Lawyers Council of Thailand and is an ordinary member of the Thai Bar Association of 2013.

Contributed by: Jessada Sawatdipong, Sarunporn Chaianant, Supawich Nimmansomboon and Supawin Pongthananikorn, **Chandler MHM Limited**

Supawich Nimmansomboon is an associate at Chandler MHM Limited (CMHM) in the banking and finance practice group. He is experienced in providing advice on a wide range of legal areas, including banking, finance, aviation, general corporate and business. Supawich's experience includes acting for both lenders and borrowers on renewable energy projects and on various cross-border financing transactions. In addition to holding a permanent licence to practise law from the Lawyers Council of Thailand, he is also an ordinary member of the Thai Bar Association.

Supawin Pongthananikorn is an associate at Chandler MHM Limited (CMHM) in the banking and finance practice group, specialising in a diverse range of legal areas. His expertise spans mergers and acquisitions, project finance and corporate finance transactions. He advises on regulatory, compliance, corporate, commercial and ESG-related matters for clients. He has been engaged in legal research on various topics as well as matters involving due diligence and contract review in the real estate, energy, and industrial sectors.

Chandler MHM Limited

17th and 36th Floors
Sathorn Square Office Tower
98 North Sathorn Road
Silom, Bangrak
Bangkok 10500
Thailand

Tel: +66 2009 5000
Fax: +66 2009 5080
Email: cmhm_info@mhm-global.com
Web: www.chandlermhm.com

CHANDLER MHM

Contributed by: Jessada Sawatdipong, Sarunporn Chaianant, Supawich Nimmansomboon and Supawin Pongthananikorn, **Chandler MHM Limited**

Technology and Data in the Financial Services Sectors

The financial services sector in Thailand, much like in other parts of the world, is experiencing a digital transformation. Many financial institutions are shifting away from traditional "bricks and mortar" models, embracing digital platforms and broadening their range of digital services beyond conventional banking.

We have outlined below some key developments in the financial services sector in relation to the digital transformation.

Virtual bank

The Bank of Thailand (BOT) has proposed a policy that will allow new and existing players to establish virtual banks. The scope of virtual banks is the same as that of traditional banks, and they will be required to be established and headquartered or have a parent company in Thailand in order to be supervised.

A key element differentiating virtual banks from traditional banks is that virtual banks do not have physical branches and will generally offer services through a digital channel. In its consultation paper, the BOT has articulated a clear and strategic vision for the role of virtual banks in the financial ecosystem. The primary objectives are twofold: to significantly reduce operating costs and to improve the accessibility of financial services for consumers.

Under the BOT's "open competition policy", new players are invited to compete in the banking market using new formats that meet the needs of customers. The BOT imposes a licensing framework for virtual banks which includes the place of establishment, paid-up registered capital, cyber security certification system requirements, and an exit plan, among other requirements. In June 2023, the BOT issued a consultation paper on virtual banking and held a public hearing to gather feedback on the proposed framework. A few players, including SCB X Public Company Limited and Kakao Bank, have confirmed that they will apply for a virtual bank license. Further, SCBX has confirmed that it is ready to commence the license application process and has forged a partnership with Kakao Bank to establish a consortium to upgrade its technology to meet the needs of its customers.

Digital currency – Central Bank digital currency

Since 2018, the BOT has been exploring adopting a central bank digital currency (CBDC) for inbound and cross-border transactions through many projects, such as Project Inthanon, Project Inthanon-LionRock, and Project mBridge. Project mBridge was conducted in collaboration with the Hong Kong Monetary Authority, the Central Bank of the United Arab Emirates, and the Digital Currency Institute of the People's Bank of China with the Bank for International Settlement Innovation Hub as a supporter. The project testing took place in 2022. The testing evaluated three types of transactions: (i) issuance and redemption (ii) cross-border payment; and (iii) cross-border exchange. The test involved 20 participants from four different countries.

Test results revealed that conducting cross-border money transfers and currency exchanges on the mBridge system using CBDC could enhance the efficiency of international fund transfers with less reliance on correspondent banks compared to current fund transfer systems. The mBridge system reduces transfer times from the current three to five days to mere seconds, with lower transaction costs and settlement risk. It also promotes local currency usage for international payments.

In the next phase, the mBridge project aims to leverage technology for the development of systems and features that can efficiently support transactions. The BOT will further assess the feasibility of expanding the scope of development and testing the practical application of the mBridge project.

Sustainable Solutions to Thailand's Structural Debt Overhang Problems–Responsible Lending

The structurally high level of household debt in Thailand impacts the quality of life of the debtors and the stability of the financial system. In light of this, in February 2023, the BOT released a Directional Paper titled "Sustainable Solution to Thailand's Structural Debt Overhang Problems", aiming to provide a comprehensive understanding of Thailand's household debt situation and to communicate the fundamental approaches for addressing the debt in a holistic and systematic manner. This approach requires time and collaborative efforts from all sectors. Since 2020, the BOT's primary focus has been on assisting debtors who have been impacted by COVID-19. As the situation has gradually improved, the BOT has pivoted its strategy to tackle more long-term challenges associated with debt repayment. At the forefront of this strategic shift is the concept of "responsible lending", a multi-faceted approach aimed at addressing persistent debt issues. An important element of responsible lending is that advertising should not encourage reckless borrowing or debt accumulation; instead, it should encourage responsible borrowing behaviour, offering loan products that are tailored to meet the specific needs and financial circumstances of individual borrowers. This ensures that loans are not only accessible but also aligned with the borrower's ability to manage repayments effectively.

These measures will be enforced from 2024 except for the provisions related to persistent debt (where the amount of interest is greater than the principal during the past five-year period), which will take effect from 1 April 2024. Furthermore, the BOT is also in the process of considering additional measures for household debt management. This includes testing a Sandbox project for implementing risk-based pricing (RBP) and debt service ratio (DSR) criteria.

Green-Financing: Investing in a Sustainable Future–Environment, Social and Governance (ESG)

The financial services sector in Thailand is playing its part in adopting the principles of ESG into its business model. This is strongly supported by the Thai Government which attended and seeks to implement the outcomes of the United Nations Climate Conference (COP27).

Many more financial institutions are setting goals for aligning their lending criteria with the principles of ESG. This means that businesses need to understand the transition to ESG compliance throughout their business life cycle, from seeking finance to managing supply chains, when making any investment decisions. We have outlined below some of the recent developments with respect to ESG.

Bio-Circular-Green

The Thai government has launched the Bio-Circular-Green Economy (BCG) framework to steer the country's recovery following the COVID-19 pandemic. A BCG economy encompasses the "Bioeconomy", "Circular Economy" and "Green Economy". The BCG approach prioritises leveraging science, technology, and innovation to transform Thailand's inherent strengths in biological and cultural diversity to gain a competitive edge. Its primary objectives include advanc-

ing the sustainability of biological resources, empowering communities, and fostering the transition towards a low-carbon society in line with the UN Sustainable Development Goals. Financial institutions are continuously integrating the principles of ESG into their product offerings which support the Bio-Circular-Green Economy (BCG) framework. This includes providing green financing options, promoting ESG investments, assisting in mitigating ESG-related risks and supporting innovation in sustainable technologies. Financial institutions are moving towards responsible practices that align with sustainability and resource efficiency.

Additionally, under the Investment Promotion Act B.E. 2520, businesses that comply with BCG classifications qualify for a reduction in corporate income tax and various incentives, both tax-related and non-tax-related. Further advantages include exceptions or reductions in import duties applied to machinery, raw materials, and research and development materials as stipulated in the investment-related laws. One sector which is rapidly adapting to the BCG framework is the energy sector. The Ministry of Energy promotes waste-to-energy production with the inclusion of community participation and has also announced the purchase of power generated from renewable energy resources and municipal solid waste. In response to this, there are likely to be more stringent regulations and measures for businesses to comply with, ensuring that activities engaged in environmentally impactful products, goods, and services uphold their environmental responsibilities.

Environment conservation bonds

The Securities and Exchange Commission of Thailand (SEC) is taking steps to promote ESG principles within the Thai capital markets by evaluating a company's performance in terms of its environmental impact, social responsibility, and corporate governance practices. The SEC is actively promoting the issuance and offer for sale of green bonds, social bonds, and sustainability bonds (collectively referred to as "environment conservation bonds") which are to finance sustainable projects. The issuers must comply with SEC regulations and international standards such as the ASEAN Bond Standards or the International Capital Market Association Bond Principles (ICMA). Moreover, the SEC has established regulations and guidelines for sustainability and set incentives for participating in green finance by waiving the requirement for official fees with respect to ESG-related bond issuances.

Thailand sustainability investment

As a regular practice, the Stock Exchange of Thailand (SET) annually announces a list of Thai-listed companies that have been selected to be part of Thailand Sustainability Investment (THSI). This list comprises companies that engage in sustainable business practices and uphold ESG principles, demonstrating a commitment to responsible business operations. The concept of sustainable investment, focusing on ESG, has become a prominent trend among investors. In 2022, the number of companies included in the THSI list increased significantly to 166 companies, up from 144 companies in 2021. This uptick signifies the growing importance and recognition of corporate sustainability, both from the market and the wider public's viewpoint. With SET's vision "To Make the Capital Markets 'Work' for Everyone" – ie, to promote inclusive and responsible capital markets, the SET actively supports listed companies in operating businesses in a responsible manner to foster resilience and sustainable growth. According to the SET, 80% of individual investors in Thailand engage in trading stocks of companies with sustainable attributes, holding at least one such company in their

investment portfolio, while institutional investors and lenders are integrating ESG factors into their investment and lending decisions to support the development of sustainable products. Financial institutions are increasingly engaging in sustainable banking by supporting projects which have a positive impact in line with ESG principles.

Carbon market and carbon financing

There has been a growing interest in the carbon credit market around the world. Unlike some other countries which implement compliance or a mandatory carbon market, Thailand adopts a voluntary carbon market. Whilst there is no legal requirement for businesses to reduce or maintain their greenhouse gas emission level, certain Thai business operators are approaching this issue very seriously resulting in carbon credit playing an important role in various sectors.

The Thailand Voluntary Emission Reduction Program (T-VER Program) was developed and introduced by the Thailand Greenhouse Gas Management Organization (TGO) as a mechanism for obtaining carbon credits in Thailand. The T-VER program enables projects to generate carbon credits which can be used to offset greenhouse gas emissions or be sold to businesses that are unable to reduce their own emissions. Recently TGO has introduced a Premium T-VER project which incorporates additional methodologies aligned with international standards. Thailand has to navigate pressures from foreign entities regarding environmental measures, including the practices of multinational companies, especially from the European Union (EU). This requires advance preparation and adaptation; for instance, from 1 October 2023, the EU plans to impose a carbon price at its borders, known as the Carbon Border Adjustment Mechanism (CBAM), impacting Thai products such as cement, steel, and fertilisers. This incurs additional costs for Thai exporters who normally engage in their export business in the EU market. There is also a platform for trading carbon credits established to promote the liquidity of the carbon market and to create economic incentives for emissions reduction. In terms of the financing market, financial institutions have played a significant role in supporting projects that generate carbon credits and integrate carbon offset programmes. Carbon credits can now be connected with derivatives transactions (ie, futures, options, and swaps) as they help businesses manage climate-related and transition risks. Early this year, Krung Thai Bank Public Company Limited, PTT Public Company Limited and PTT International Trading Pte Ltd signed a memorandum of understanding (MOU) relating to carbon credit-linked derivatives with an aim to mitigate risks in carbon prices and greenhouse gas emissions. The MOU would serve as a prototype project for developing a market of carbon credit-linked derivatives for risk management or other trade products in the future.

Emerging Innovation in Financial Markets

Payment systems

The BOT has introduced a three-year strategic plan (2022-2024) to make digital payments the primary method for accessing banking services for all and to enhance Thailand's competitive edge while transitioning towards a cashless society. The strategy focuses on:

- openness – utilising shared payment infrastructure and data for efficiency and to promote competition;
- inclusivity – encouraging accessible and understandable payment services for all; and
- resiliency – implementing flexible oversight to effectively manage digital-era risks.

The objective is to increase the frequency of usage of digital payments up to 2.5 times or an equivalent of 800 transactions per person per year.

Foreign exchange ecosystem

The volatility of the Thai Baht currency arises from external factors, primarily related to the economies of major countries together with internal factors such as economic and political uncertainty and foreign investments by Thai investors. Business owners have to be able to adapt to unpredictable currency fluctuations in order to shield their businesses from these risks. Simultaneously, the BOT is working to help business owners navigate the new FX ecosystem to ensure more efficient exchange rate transactions. The concept of the FX Ecosystem is a long-term strategy pursued by the Thai government to continuously adjust the structure of the foreign exchange rate system, benefiting both domestic entrepreneurs and foreign investors.

The FX Ecosystem aims to promote the use of local currency and provide more flexibility in regulations on funds transfer. This involves expanding the scope of permitted outward remittances and their maximum amounts. for The requirement for case-by-case approval will be lifted for Thai companies wishing to provide funds to their foreign parent companies for notional pooling. Furthermore, the investment cap for foreign securities by individual investors, without intermediaries, will be increased from USD5 million to USD10 million.

From a foreign investors' standpoint, this FX Ecosystem will help expand the scope of the Non-Resident Qualified Company (NRQC) programme to allow foreign companies engaged in cross-border payments to participate in the programme, in addition to foreign companies that are obligated to receive or make payment in THB from direct trade or investment in Thailand. The measure aims to facilitate transactions between foreign companies and Thai financial institutions. Furthermore, the FX Ecosystem enables foreign investors who invest in the Thai securities market to hedge against exchange rate risks with Thai financial institutions, without having to process through intermediary financial institutions abroad. These measures are designed to create a more robust FX ecosystem, supporting businesses in navigating the challenges posed by currency volatility.

Bill on the Supervision of Hire Purchase and Leasing of Automobiles and Motorcycles

Although the number of hire purchase and vehicle leasing businesses operated by non-banks in Thailand has steadily increased, there has never been clear supervision over such activities. Currently, there is no specific regulation governing the hire purchase and leasing of vehicles business–only provisions of general laws – ie, the Thai Civil and Commercial Code, which would apply to the hire purchase or leasing transaction in general, and Notification of the Contract Committee re: the Hire Purchase of Car and Motorcycle Business as a Contract-Controlled Business B.E. 2565 (2022), which specifies that the hire purchase business is a contract-controlled business and as such the hire purchase agreements are subject to certain requirements set forth thereunder. This notification applies only to Business-to-Consumer hire purchase businesses, not Business-to-Business businesses.

However, recently, the BOT and the Fiscal Policy Office have been preparing to incorporate a specific legal framework to oversee and regulate car and motorcycle leasing and hire purchase businesses through their introduction of a bill on supervision of the hire purchase and lease of

automobiles and motorcycles (the "Bill"). When in force, the Bill will bring hire purchases by non-banks and leasing companies under the BOT's supervision.

The key elements of the Bill are outlined below.

Regulate and close a loophole

Personal hire purchase of cars for personal use, personal hire purchase of cars for business use and hire purchase of cars by a legal person will be regulated. Moreover, business operators are required to disclose details regarding interest rates, service fees (the BOT is authorised to announce methods for calculating annual service fees for operators to follow), discounts, etc, and also report the same to the BOT. Additionally, the BOT, under reasonable circumstances, may require business operators to comply with various matters, including interest rates, applicable service fees, deposit amounts, collateral assets, and potential penalty fees.

Inspection of business operators

The BOT has the authority to appoint its officials or external individuals as inspectors to examine the assets, liabilities, related individuals, and operations of business operators. Therefore, the inspector shall have the authority to request information related to the business operation, assets, and liabilities of the business operator and to examine premises and operation.

Business compliance and penalties

Business operators failing to adhere to compliance under the Royal Decree are subject to fines.

Currently, the Bill is still under the consideration of the Office of the Council of State. The BOT is in the process of preparing plans to support the implementation. This includes engaging in discussions with business operators and consumers to ensure that when the law comes into effect, the BOT will be able to properly supervise and oversee the businesses to protect consumers and maintain the overall financial stability of the vehicle hire purchase and leasing industry.

USA

Law and Practice

Contributed by:
Michael Chernick, Maura O'Sullivan, Frank Oliver and Sara Coelho
Shearman & Sterling

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Shearman & Sterling is a global law firm that partners with corporations, major financial institutions, emerging growth companies, governments, and state-owned enterprises to provide the legal and industry insight needed to navigate the challenges of today and achieve their ambitions of tomorrow. For 150 years, Shearman & Sterling has built strong and long-lasting relationships with clients around the world by advising on groundbreaking, precedent-setting matters across industries and sectors. The firm has over 700 lawyers around the world speaking more than 65 languages, and nearly half of its lawyers practice outside the United States. The firm is committed to forging long-term relationships with its clients by providing genuine insight and practical advice as they navigate the challenges of the 21st-century global economy. The authors would like to thank Magnus Wieslander and Greg Wolszczak for their contributions to this chapter.

Authors

Michael Chernick is a partner in the finance practice at Shearman & Sterling. Michael has over 25 years of experience in the US leveraged finance market, representing leading investment and commercial banks, alternative capital providers and other financial institutions in bank financing and debt capital markets transactions. He has extensive experience in public and private leveraged and investment grade acquisition finance (including bridge financings), refinancings and recapitalisations, second-lien and asset-based lending. Michael also advises on securities, capital markets, bank finance, and corporate transactions representing corporations and financial institutions in bank financings, public and private offerings and high-yield debt offerings.

Maura O'Sullivan is a partner in the finance practice at Shearman & Sterling. She focuses on acquisition financings, leveraged lending, restructurings, debtor-in-possession financings and asset-based finance. Maura has extensive experience representing financial institutions and direct lenders in structuring and executing acquisition financings, leveraged lending, first- and second-lien structures. She also has significant expertise in restructuring transactions, debtor-in-possession financings and asset-based finance. Maura has also worked extensively in cross-border financings (including in connection with cross-border acquisitions).

Frank Oliver is a partner in the finance practice at Shearman & Sterling. He represents leading investment and commercial banks, direct lenders, alternative capital providers and other financial institutions. His experience includes leveraged and investment grade acquisition finance, including first- and second-lien credit facilities, bridge loans and direct lending, refinancings and recapitalisations, asset-based lending, debtor in possession and exit financings, across a broad range of industries and sectors.

Sara Coelho is a partner in the financial restructuring and insolvency practice (FR&I) at Shearman & Sterling, and works with the finance practice on private credit, direct lending and specialty finance transactions. Her finance experience includes acting for creditors and agents on a variety of financings for acquisition, capital refinancing and liquidity management-related purposes, as well as DIP financings and exit financings. Her FR&I practice focuses on restructuring and debtor-creditor rights. She represents debtors, creditors, acquirers, equity owners and other investors in insolvency matters, including risk mitigation and planning, distressed or reorganised company acquisitions, liability management, chapter 11 and out-of-court restructurings and cross-border insolvencies.

Shearman & Sterling LLP

599 Lexington Avenue
New York, New York
10022-6069
United States of America

Tel: +212 848 4000
Email: mosullivan@shearman.com
Web: www.shearman.com

SHEARMAN & STERLING

1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Following years of heightened leverage levels in the US loan market, and in connection with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in the aftermath of the 2008 global financial crisis, US federal regulators issued Interagency Guidance on Leveraged Lending (the "Guidance") in 2013.

The Guidance imposes certain requirements on regulated lenders and arrangers aimed at promoting sound risk management. Among other things, the Guidance requires regulated lenders to incorporate as part of their credit risk analysis a borrower's ability to deleverage its capital structure during the term of the loan, and to avoid loans that exceed specified leverage levels. As a result, less heavily regulated non-bank lenders and foreign financial institutions capitalised on this opportunity to increase their market share of the leveraged loan market given their ability to provide higher leverage levels and riskier loans.

Following record levels of loan issuance in late 2020 and in 2021, during 2022 and 2023, the increasing inflationary environment, combined with rising interest rates and macroeconomic uncertainty, has led to a material reduction in loan volume throughout 2022 and 2023 compared to prior years. While overall leveraged loan volumes in the US have continued to decline in 2023 compared to 2022, there has been a slight uptick in refinancings in 2023. The overall continued decline in loan volumes in 2023 has been partly driven by continuing decreased M&A activity. In particular, the volume of large committed syndicated loan financings has declined following a number of troubled larger syndications since mid-2022 in which arrangers were unable to sell such loans or such loans were sold at a steep discount.

In light of the regional banking crisis in March 2023 which affected several financial institutions in the United States, regulators have also unveiled plans which would require regional banks with at least USD100 billion in assets to, among other things, hold long-term debt to help absorb losses in the event of seizure by the government as well as requiring such banks to adhere to risk models which have been standardised for larger regulated banks in the industry.

1.2 Impact of the Ukraine War

The Ukraine war has led to increased political and macroeconomic uncertainty throughout the entire political system and has accordingly affected risk tolerance in the financial system. This has contributed to the lower loan volumes seen in 2022 and 2023 described above as well as a decrease in M&A volume in North America, with the value of deals in H1 2023 totalling approximately USD960.0 billion, a 28.5% reduction from H1 2022 levels.

With respect to US loan documentation, the uncertainty in the market has led to an increased focus on lender-protective provisions (including provisions intended to prevent future liability management transactions) which had been scaled back during prior years. The Ukraine war has also increased focus by lenders on representations and warranties and covenants relating to compliance with sanctions, anti-corruption and anti-money laundering laws.

1.3 The High-Yield Market

Companies when contemplating a capital raise have looked to both the loan and high-yield bond markets to meet their financing needs. Ultimately, borrowers will seek to obtain the correct mix

of debt instruments that offers the most favourable terms consistent with their capital needs. Further, given the rising interest environment in 2023, fixed interest rate debt instruments have become more attractive, but investors have been increasingly requiring security in these fixed-rate instruments evidenced by the increasing prevalence of secured high-yield bond issuances, which represented approximately 63.24% of total high-yield bond issuances in 2023. In addition, given the economic backdrop of the relatively high cost of capital compared to recent periods, companies have been issuing shorter maturity instruments to reduce the costs of redeeming such debt when the interest rate environment becomes more issuer-friendly.

Covenant terms and protections in the high-yield bond market have continued their long-term convergence with those of the leveraged loan market, which is demonstrated clearly by the proliferation of "covenant-lite" term loans, which represented approximately 92.41% of all new-money first-lien leveraged loan issuances as at the end of August 2023.

Certain differences remain between leveraged loan and high-yield bond terms. Loans continue to provide weaker "call" protection in connection with voluntary prepayments. Additionally, in capital structures with both leveraged loans and bonds, lenders typically continue to drive the guarantee and collateral structure and control enforcement proceedings given the increased focus on collateral from a loan perspective.

Providers of leveraged loans continue to push to restrict investments in non-guarantor subsidiaries more often than investors of high-yield bonds. Additionally, many loans contain "most favoured nation" (MFN) protections that require an interest rate reset upon the issuance of certain higher-yielding debt, subject to carve-outs which traditionally limit the duration of the MFN and other limitations on MFN as specifically negotiated in the credit documentation.

Finally, there are still a few respects in which loans contain more permissive terms than bonds, such as:

- the lack of a fixed-charge coverage governor on the usage of the "available amount" builder basket for restricted payments;
- allowing amounts in the "available amount" builder basket to build for positive cumulative consolidated net income in a given period without a corresponding deduction for negative amounts in other periods; and
- permitting the incurrence of debt by "stacking" based on priority (eg, by first incurring junior lien debt in reliance on a secured leverage ratio and then incurring first lien debt in reliance on a first lien leverage ratio), rather than the bond standard secured leverage governor applying to all such secured debt, regardless of priority (at least in the case of unsecured bonds).

1.4 Alternative Credit Providers

With private debt funds in North America raising more than USD500 billion since 2020 as well as the lack of regulatory restrictions on such funds, alternative credit providers have significantly increased their market share of the US loan markets.

Direct lending (in which loans are made without a bank or other arranger acting as intermediary) has grown dramatically over the last several years. Although these asset managers historically operated largely in the middle market and focused on smaller corporate borrowers, direct lenders have become financing sources for all

manner of top-tier transactions by providing, (i) "anchor" orders in syndicated facilities, (ii) "bought" second lien (or otherwise difficult to syndicate) tranches; and/or (iii) complete financing solutions to large corporate borrowers and private equity sponsors.

Direct lenders are often willing to provide financing at higher leverage multiples or allow a portion of interest to be paid in kind as well as loan into parts of the capital structure that are not readily available in the broadly syndicated market, such as preferred equity, holding company (structurally junior) loans or unitranche facilities.

In addition, direct lenders offer faster execution speed and certainty of terms, since there is no marketing process and thus no requirement for a marketing period or modification of loan terms during syndication.

1.5 Banking and Finance Techniques

In recent years, as a result of intense competition among bank and non-bank lenders to lead financing transactions, there has been a marked increase in documentation flexibility – albeit with a recent pullback in the latter part of 2022 and during 2023. Private equity sponsors have been key drivers of this increased flexibility, as recurring customers in the syndicated and direct loan markets with increasing market sway, they have been able to push for more aggressive terms in each subsequent transaction. Often, borrowers require lenders to rely on underwritten borrower-friendly loan documentation precedents to ensure that the terms of the new financing are at least as favourable to the borrower as its most recent financing (often with "market flex" rights in syndicated financings to remove the most aggressive terms if necessary to achieve successful syndication of the loan). Lenders wishing to stay competitive in the leveraged loan market have been under pressure to be increasingly selective on the terms they resist in negotiations, even on the flex terms.

Given the past year's uncertainty in the market, however, there has been a pullback of the most aggressive terms seen in the market in 2021. There has also been an increased focus from lenders on provisions aiming to protect lenders against liability management transactions (as further explained below).

Another trend seen in the US market in recent years is the growth of debt financings at the Holdco level. Private equity sponsors' desire to be more competitive in auction processes, and non-bank lenders (as well as, in recent years, bank lenders) that are seeking to deploy additional capital at attractive returns, have contributed to the growth of these Holdco financings. Holdco financings often include a payment-in-kind interest construct which enables the opco structure to keep operating without the need to service additional cash interest and amortisation payments. The issuers of the Holdco loans or notes are structurally subordinated to any debt at the opco level and typically do not have recourse to the assets at the opco level. Therefore, the Holdco lenders are typically not party to any intercreditor agreement with the opco lenders. Another manner in which to accomplish a financing with similar features is through the issuance of preferred equity at the Holdco level.

1.6 ESG/Sustainability-Linked Lending

There has been a growing trend among participants in the US loan market to tether loan pricing with a borrower's ability to achieve predetermined ESG or sustainability-linked objectives. Certain borrowers perceive this tool as a means of accomplishing dual objectives: (i) building heightened sustainability profiles integrating

ESG-oriented goals that will appeal to investors and the public, and (ii) securing lowered interest rates and fees on their credit facilities.

Partly driven by mounting pressure to evidence the legitimacy of their sustainability and ESG credentials, borrowers will typically collaborate with a third-party sustainability structuring agent to develop precise ESG benchmarks that will be monitored throughout the loan's duration. Interest rate margins and fees will ratchet up or down depending on performance against pre-set sustainability and ESG targets. Over time, these benchmarks frequently evolve to become more rigorous. Increasingly, materiality of the margin ratchets has been criticised by participants who question whether it is significant enough to motivate the change.

2. Authorisation

2.1 Providing Financing to a Company

In the US, banks (and credit unions) have the option of being chartered by a state government or the federal government under a so-called dual chartering system. Banks which are chartered by state banking authorities are primarily subject to the regulations of the relevant state authority, and may also be regulated or supervised by the Federal Reserve and/or Federal Deposit Insurance Corporation (FDIC). Banks chartered by the federal government on the other hand are subject to regulation by the Officer of the Comptroller of the Currency (OCC) and are required to become members of the "Federal Reserve System". Under federal law, federal and state banks are also required to obtain insurance from the FDIC protecting depositors.

Although alternative credit providers, direct lenders and other non-bank lenders are primarily subject to Securities and Exchange Commission (SEC) rules and regulations, they may also be subject to regulation under the Investment Company Act (ICA) as an "investment company". However, such lenders are often exempt from many of the ICA's requirements and regulations.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Foreign Lenders are subject to the (i) International Banking Act and (ii) the Foreign Bank Supervision Enhancement Act as well as regulated by the Federal Reserve, whose approval is necessary to establish foreign banking institutions in the US.

Also, foreign banking institutions are required to seek approval from the OCC or state banking supervisor to establish US branches and agencies.

In 2019, the Federal Reserve finalised new regulatory requirements for US subsidiaries of foreign banks. These provided relaxed capital and stress-testing requirements, while also imposing stricter liquidity requirements.

3.2 Restrictions on Foreign Lenders Receiving Security

Under US law, granting security interests to, or providing guarantees in favor of, foreign lenders generally does not differ from regulations that apply to domestic lenders.

3.3 Restrictions and Controls on Foreign Currency Exchange

The USA does not currently impose any foreign currency exchange controls affecting the US loan market, unless a party is in a country that

is subject to sanctions enforced by the Office of Foreign Assets Control (OFAC) of the US Department of the Treasury. OFAC administers and enforces economic and trade sanctions based on US foreign policy and national security goals.

3.4 Restrictions on the Borrower's Use of Proceeds

Loan agreements in the USA traditionally have negative covenants limiting the borrower's use of loan proceeds to specified purposes as set forth in the Loan Agreement.

Furthermore, US law restricts the use of loan proceeds that are in violation of the margin-lending rules under Regulations T, U and X, which limit financings used to acquire or maintain certain types of publicly traded securities and other "margin" instruments if the loans are also secured by such securities or instruments.

3.5 Agent and Trust Concepts

In US syndicated loan financings, an administrative agent is appointed to act on behalf of the lending syndicate to administer the loan. Further, in some secured transactions, a separate and distinct collateral agent is appointed to coordinate collateral-related matters. When financings involve numerous series of debt securities or multiple lending groups sharing the same collateral, security interests are sometimes granted to collateral trustees or other "intercreditor" agents to act on behalf of all creditors, with the trust or intercreditor arrangements setting out the relative rights of the various creditor groups.

3.6 Loan Transfer Mechanisms

In the US loan market, lenders have the option to transfer their interest under credit facilities to other market participants through either assignments or participations. An assignment is the sale of all or part of a lender's rights and obligations under a loan agreement, upon which the assignee replaces the assigning lender under the loan agreement with respect to the portion of commitments or loans assigned. As the new "lender of record", the assignee benefits from all rights and remedies available to lenders thereunder and takes on the obligations of the lenders.

Assignments will usually require the consent of the borrower, the administrative agent and – in the case of revolving facilities including letter of credit and/or swingline subfacilities – the letter of credit issuers and the swingline banks. Loan agreements often provide for some limitations on borrowers' consent rights during the continuation of any event of default – or, increasingly, only during the continuation of a payment or bankruptcy event of default.

Usually, borrower consent is not required in connection with assignments to another lender (or an affiliate or "approved fund" of such lender). Typically, in cases where borrower consent is required, in the absence of any objection from the borrower within a specified period of time (usually five to 15 business days), the borrower is deemed to have consented to such assignment. In some instances, deemed consent only applies to assignments in respect of term loans but not revolving facilities.

In contrast, participations involve a transfer of a limited amount of the lender's rights, which traditionally are focused on the right to receive payments on the loan and the right to direct voting on a limited set of "sacred rights". The transferee becomes a "participant" in the loan but does not become a lender under the loan documentation and has no contractual privity with the borrower. Participations rarely require notice to or consent from the borrower or any other party. However, some borrowers have sought to impose limi-

tations on these participation rights, including consent and notice requirements.

Increasingly, loan agreements restrict assignments and participations to "disqualified institutions", which generally include the borrower's competitors and certain financial institutions that the borrower deems undesirable.

3.7 Debt Buy-Back

Borrowers and their affiliates (including in some cases private equity sponsors) are able to purchase loans in the US syndicated loan market, subject to customary requirements and restrictions.

In addition, private equity sponsors and their affiliates (other than borrowers and their subsidiaries) are typically allowed to make "open-market" purchases of loans from their portfolio companies on a non-pro-rata basis. Once held by a borrower affiliate, these loans are normally subject to restrictions on (i) voting, (ii) participating in lender calls and meetings and (iii) receiving information provided solely to lenders.

Loans held by private equity sponsors and their affiliates are also subject to a cap of the aggregate principal amount of the applicable tranche of term loans which is traditionally in the range of 25–30%. Bona fide debt fund affiliates of private equity sponsors that invest in loans and similar indebtedness in the ordinary course are usually excluded from these restrictions, but are still restricted from constituting more than 49.9% of votes in favour of amendments requiring the consent of the majority of lenders.

3.8 Public Acquisition Finance

The US does not have specific rules or regulations requiring "certain funds" requirements with respect to financing acquisitions of public companies. However, financing commitments with respect to both public and private company acquisitions are generally subject to a limited set of "SunGard" conditions due to the absence of a financing condition in most acquisition agreements. The "SunGard" conditions typically include:

- accuracy of certain "specified representations" relating to the enforceability and legality of the financing itself;
- accuracy of certain material seller or target representations made in the acquisition agreement, the breach of which would permit the buyer to terminate the acquisition;
- absence of a material adverse change with respect to the target (on terms identical to the corresponding condition to the acquisition); and
- conditions relating to the timing required by arrangers to properly syndicate the loans in advance of acquisition closing (either in the form of marketing periods or an "inside date").

Given these dynamics, it is customary for buyers/borrowers and arrangers to execute commitment letters, including detailed term sheets that usually include the parties agreeing on precedent documentation, simultaneously with signing the acquisition agreement. This provides buyers with committed financing, subject to this customary "limited conditionality".

3.9 Recent Legal and Commercial Developments

In the recent economic climate, some borrowers who are facing adverse economic conditions have looked to execute liability management transactions (which need to be permitted by their credit documentation).

One recent example of such a transaction involves a borrower seeking the release of guarantors that are no longer wholly owned by the borrower (even if wholly owned by its affiliates). Following such release, the released entities would more easily be able to incur additional indebtedness. Lenders have increasingly sought protection from this type of transaction by permitting the release of a guarantee only in certain circumstances (eg, the guarantor becomes non-wholly owned in a bona fide transaction involving a third party without the intent of releasing the guarantee as part of the transaction).

Another recent example is the use of multiple-step processes (where each step is permitted under the investment covenant) to move valuable IP and other assets from guarantors to non-guarantor entities, thereby automatically releasing the lenders' security interest in such assets in the process. Lenders have, similarly, sought to limit or even completely eliminate this flexibility.

Furthermore, borrowers have increasingly used flexibility in the amendment section to make updates to credit documentation that allow for a majority of lenders to gain a benefit over the minority lenders. Recent transactions have allowed for a majority of lenders to subordinate, in both right of payment and on the liens, existing debt for new debt which the majority lenders are providing. Certain lenders have sought to limit this flexibility by modifying amendment provisions so that any priming debt is required to be offered to each lender on a pro-rata basis.

3.10 Usury Laws

Nationally chartered banks may not charge interest exceeding the greater of (i) the rate permitted by the state in which the bank is located or (ii) 1% above the discount rate on 90-day commercial paper in effect in the bank's Federal Reserve district.

If the state where the bank is located does not prohibit usurious interest, banks may not charge interest exceeding the greater of 7% or 1% above the discount rate on 90-day commercial paper in effect in the bank's Federal Reserve district. In general, federal law will pre-empt any state usury law that prohibits state-chartered banks from applying the same interest rate as a nationally chartered bank.

Under New York law, with certain exceptions, charging interest in excess of 16% constitutes civil usury, and charging interest in excess of 25% constitutes criminal usury. However, loans in excess of USD250,000 are exempt from the civil statute, but remain subject to the criminal statute. Loans in excess of USD2.5 million, which include nearly all broadly syndicated loans in the US, are exempt both from New York's civil and criminal statutes.

3.11 Disclosure Requirements

There are no rules or laws in the US that prohibit certain disclosure of financial contracts, but in credit documentation there is traditionally a confidentiality section that prohibits the lenders from disclosing the nature of the financing other than in pre-agreed situations.

4. Tax

4.1 Withholding Tax

The US tax rules contain a complex withholding regime that imposes, in certain circumstances, a withholding tax of up to 30% on payments of interest to non-US lenders. In order to encourage international lending to US borrowers, however, the rules contain various exemptions from this

withholding tax. Under current law, the expectation is that lenders to a US obligor should generally be able to qualify for one or more of these exceptions, such that lenders are not subject to the withholding tax and obligors are not required to compensate lenders under a "gross up" provision in credit agreements. In order to benefit from these exemptions, however, lenders must provide certain certifications to borrowers or their agents, generally on tax forms published by the Internal Revenue Service (IRS), as discussed below. Parties to credit agreements with US obligors should ensure that such forms are appropriately addressed in loan documentation and furnished in practice.

This withholding tax regime may also apply to certain other payments and income arising from loans. If a loan is issued at a discount in excess of a de minimis amount (original issue discount, or OID), this discount is treated as interest income when paid, subject to the withholding tax. Certain fees may also be treated as OID for this purpose.

As mentioned above, there are several exemptions from the withholding tax on interest. The most notable exemption is the portfolio interest exemption, which is the basis for many non-bank lenders to eliminate withholding. In the case of banks and other lenders that do not qualify for the portfolio interest exemption, US tax treaties may eliminate withholding or reduce the rate. Finally, if non-US banks lend from their branch in the United States (a "US trade or business"), the withholding tax generally does not apply.

To qualify for one of these exemptions, non-US lenders are generally required to provide a US tax form to the borrower or agent – usually an IRS Form W-8BEN-E (for treaty benefits or the portfolio interest exemption) or IRS Form W-8ECI (if the interest is effectively connected with the non-US lender's US trade or business). Additional certifications and forms are required in certain instances involving flow-through entities or intermediaries.

Another withholding regime that may apply to certain payments of interest and OID is the "backup withholding" regime, which generally applies to domestic payments (currently at a withholding rate of 24%) in circumstances where a US lender fails to provide certain information and certifications required for purposes of the US information reporting regime. Backup withholding is usually eliminated by the provision of an IRS Form W-9 and, if it is imposed, generally can be recovered in the form of a credit on the lender's US tax return.

Principal payments and proceeds from a sale or other disposition of debt instruments are not subject to US withholding tax (except to the extent that such payments are treated as a payment of interest or OID). However, fee income that is not treated as OID may be subject to 30% withholding unless a treaty applies or the recipient is engaged in a US trade or business. The portfolio interest exemption may not apply to such fees because they may not be treated as interest for US tax purposes.

Finally, the Foreign Account Tax Compliance Act (FATCA) may impose a 30% US withholding tax on non-US banks and financial institutions (including hedge funds) that fail to comply with certain due diligence, reporting and withholding requirements. FATCA withholding tax applies to payments of US-source interest and fees, without any exemptions for portfolio interest or treaty benefits. Originally, FATCA was also intended to apply to payments of gross proceeds from a sale or other disposition of debt instruments of US

obligors. However, the Internal Revenue Service (IRS) and US Department of the Treasury issued guidance in 2018 stating that no withholding will apply on payments of gross proceeds. In the case of payments that are within FATCA's purview, the recipient must generally certify its compliance with FATCA in order to avoid a punitive 30% withholding tax (on the same IRS W-8 forms described above).

Many countries have entered into agreements with the USA to implement FATCA (Intergovernmental Agreements, or IGAs), which may result in modified requirements that apply to financial institutions organised in such countries.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Under Section 956 of the Internal Revenue Code, if a foreign subsidiary of a US borrower that is a controlled foreign corporation (CFC) guarantees the debt of a US-related party (or if certain other types of credit support are provided, such as a pledge of the CFC's assets or a pledge of more than two-thirds of the CFC's voting stock), the CFC's US shareholders could be subject to immediate US tax on a deemed dividend from the CFC.

Following regulatory changes published by the US Treasury and the IRS in 2019, US borrowers may obtain credit support from CFCs without incurring additional tax liability if certain conditions are met. However, despite these regulatory changes, the majority of loan documents today continue to maintain customary Section 956 carve-outs. This excludes CFCs from the guarantee requirements and limits pledges of first-tier subsidiary CFC equity interests to less than 65%.

Separately, non-US lenders should closely monitor their activities within the USA to determine whether such activities give rise to a US trade or business or a permanent establishment within the USA. If so, they could be subject to US taxation on a net income basis.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

The primary tax concerns that arise for non-US lenders to US obligors are those summarised in **4.1 Withholding Tax**; ie, withholding tax on interest, including FATCA withholding. To mitigate these concerns, it is important for non-US lenders and US obligors to ensure that appropriate tax forms are exchanged in order to establish any exemptions from these withholding regimes.

Although the US tax rules do not address non-money centre banks per se, the various regimes described in **4.1 Withholding Tax** (including IRS tax forms, the portfolio interest exemption and FATCA) apply differently and impose different requirements based on the particular circumstances and business activities of the lender.

5. Guarantees and Security

5.1 Assets and Forms of Security

The norm for secured financings in the US is that the collateral package consists of substantially all assets of the borrowers and their subsidiaries, with certain negotiated exceptions, which are typically meant to exclude assets with burdensome perfection requirements and/or where a pledge would lead to expensive or other negative consequences for the borrowers which outweigh the benefit to the lenders. Common exclusions include:

- leased real property and owned real property with a value below an agreed threshold;
- equity interests in certain non-guarantor subsidiaries, such as captive insurance companies and certain special purpose vehicles;
- contractual rights (including licenses) prohibited to be pledged by law or contract (although the proceeds thereof are generally included);
- assets requiring the consent of a third party or governmental agency to be pledged;
- assets with de minimis value;
- assets the pledge of which would lead to negative tax consequences for the borrowers
- assets subject to burdensome perfection regimes such as certificates of title (including motor vehicles, aircraft, railcars and maritime vessels); and
- "intent-to-use" applications for the registration of a trade mark.

The creation of security interests for most categories of personal property are governed by the Uniform Commercial Code (UCC). The requirements for creating enforceable security interests with respect to personal property under Article 9 of the UCC are the following:

- the lender must provide value to the grantor of the security interest;
- the grantor must have rights in the collateral or the power to transfer rights in the collateral to the lender; and
- either the grantor must execute a security agreement, which must be authenticated by the grantor and describe the collateral, or, in the case of certain types of collateral, the collateral must be in the possession or control of the lender.

To create a security interest in assets not governed by the UCC (eg, real property and certain kinds of intellectual property), the parties will typically create separate collateral documents or mortgages pursuant to applicable legal requirements in the jurisdiction governing the property.

Lenders must perfect such security interest to obtain priority vis-à-vis other creditors. The relevant perfection requirements under Article 9 of the UCC depend on the asset type, but generally Article 9 of the UCC provides the following four methods of perfecting security interests in domestic personal property:

- filing a UCC-1 financing statement in the appropriate jurisdiction (which is a short document setting forth basic information about the grantor and the secured party, and a description of the collateral);
- possession, in the case of certain tangible assets;
- establishing control, which may be effected by entering into control agreements in the case of deposit accounts, letter of credit rights, investment accounts and electronic chattel paper; and
- perfection upon attachment (ie, automatically upon the creation of the security interest), in the case of certain other personal property.

Perfection of security interests in federally registered copyrights (and, by custom, patents and trademarks) requires filing with the US Copyright Office (or the US Patent and Trademark Office), in accordance with federal law. Various state and federal laws govern perfection of security interests in motor vehicles, aircraft, ships and railcars, with separate registries and perfection steps required for such categories. Mortgages in real property are perfected by recording such mortgages (or equivalent documents) with the local (usually county-level) recording office where the real property is located.

5.2 Floating Charges and/or Similar Security Interests

Article 9 of the UCC permits the granting of a floating lien in the form of an "all assets" pledge, which can include all personal property owned by the grantor. Further, there is no distinction between floating and fixed charges in the US, so the granting of security interests over personal property normally covers both presently owned and later acquired assets. Importantly, however, "all assets" pledges apply only to personal property that is subject to the requirements of Article 9 of the UCC (with certain exceptions for asset types such as commercial tort claims, which must be described with more specificity). Other assets – such as real property and federally registered copyrights – cannot be subject to floating liens. For certain asset types, such as motor vehicles, creation of a security interest is governed by Article 9 of the UCC, but perfection is governed by state certificate of title laws, so perfection of security interests over such assets cannot be obtained by filing a UCC-1 financing statement.

5.3 Downstream, Upstream and Cross-Stream Guarantees

In the US, there are generally no limitations or restrictions on the provision of guarantees to related parties. However, in order to prevent a guarantee from being rendered unenforceable on the grounds of fraudulent conveyance, downstream, upstream and cross-stream guarantees should provide for a limit on the amount that is guaranteed; in order to avoid being a fraudulent conveyance, the guarantor must either receive adequate consideration or must not be rendered insolvent after giving effect to such guarantee. Customary limits contained in guarantees are designed to avoid the guarantor from being rendered insolvent. In addition, loan market participants often require borrowers and their subsidiaries to provide certifications as to their solvency at the time the loan and the guarantees thereof are made.

5.4 Restrictions on the Target

There are no rules in the US generally prohibiting a target company from guaranteeing or granting a security interest in its assets to provide credit support for a financing used to acquire its or any of its parent entities' shares. However, as is the case with guarantees and security interests generally, guarantees and security interests provided by a target company are subject to the rules on fraudulent conveyance and, in certain cases, may be subject to regulatory schemes that make such a guarantee and/or security interest impracticable even if legal. Subject to such limitations, lenders will typically require guarantees and security interests to be provided by the target company – along with delivery of any certificated securities of the target company – as a condition to the closing of an acquisition financing subject to any limits that "Sungard" provisions impose.

5.5 Other Restrictions

Anti-assignment provisions in commercial contracts pose difficult issues for lenders in secured financings. A statutory override of anti-assignment provisions in contracts is generally available under the UCC but, if the restricted collateral is critical to the collateral package, lenders are likely to require such third party to consent to the pledge as a condition to the loan so that there will be fewer complications if lenders need to enforce such pledge.

5.6 Release of Typical Forms of Security

Loan documentation in the US typically allows releases of the lenders' security interest in collateral in connection with dispositions of such collateral which are permitted under the loan

documentation. The release of all or substantially all of the collateral typically requires the consent of all lenders or, in some cases, a super majority thereof.

5.7 Rules Governing the Priority of Competing Security Interests

The relative priority of security interests held by different creditors in the same assets of a grantor is determined by the UCC of the applicable jurisdiction and is subject to the following rules:

- a perfected security interest has priority over a conflicting unperfected security interest;
- conflicting perfected security interests rank in priority according to the time of filing or perfection; and
- conflicting unperfected security interests rank in priority according to the time at which the security interest attached or became effective.

In addition, the UCC allows certain categories of collateral to be perfected by multiple methods, with priority determined based on the "preferred" method, regardless of the rules set forth above. With respect to investment property, securities accounts and certificated securities, perfection via "control" or possession has priority over perfection via filing a UCC-1 financing statement. Further, the UCC contains an exception for purchase money security interests under which a secured creditor with a purchase money security interest can obtain priority ahead of an earlier UCC-1 financing statement with respect to the purchased asset(s).

Lenders and borrowers are allowed to agree to modify the priority rules set out in the UCC and other relevant laws, by contract. The parties can also accomplish different lien priorities structurally.

Arrangements for lien subordination ordinarily provide that:

- junior creditors are subject to a "standstill" period prior to exercising enforcement rights or remedies with respect to shared collateral;
- payments from the proceeds of shared collateral received by junior creditors in violation of the agreement will be held in trust and turned over to senior creditors; and
- certain specified amendments to both senior and junior priority loan documents will be subject to agreed limitations.

Structural subordination arises where obligations incurred or guaranteed solely by a borrower are effectively junior to obligations incurred or guaranteed by a subsidiary of the borrower, to the extent of that subsidiary's assets. In such a situation, the subsidiary's creditors have the right to be repaid by such subsidiary (or out of its assets) as direct obligations of such entity in any insolvency scenario before creditors of the parent borrower – such subsidiary's equity holder – are repaid. Where the parent borrower is primarily a "holding company" for the equity interests of its operating subsidiaries, creditors of an operating subsidiary will be paid in priority to the holding company's creditors from assets of such subsidiary.

5.8 Priming Liens

Mechanic's liens arise when a contractor or mechanic performs work on property and is not paid. This lien is a security interest in the property. If the owner tries to sell the property, the debtor will have a secured interest in the portion of the proceeds needed to pay the debt.

Tax liens are placed against property by the local, state, or federal government, as author-

ised by statute, for delinquent taxes, including property, income, and estate taxes

A judgment lien is any lien placed on the defendant's assets as a result of a court judgment.

Possible structuring concerns will focus on properly conducting diligence on any possible liens, including conducting searches and other disclosure requirements as set forth in the credit documentation.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Loan and security documentation entered into in connection with a financing transaction generally provide a customary set of enforcement rights and remedies to secured parties, exercisable by such parties following the occurrence of a "default event" by an obligor.

From a statutory perspective, Article 9 of the Uniform Commercial Code (UCC) gives secured parties the right to proceed with several enforcement methods after a default event has been triggered by an obligor. These rights include:

- the right of a secured party to collect payments directly from a third-party obligor under accounts receivable, deposit accounts or with respect to certain other types of intangible assets;
- the right of a secured party to repossess collateral, either through the institution of judicial proceedings or through a non-judicial action; and
- the right of a secured party to dispose of the collateral through a public or private sale process.

However, in order to exercise such remedies under Article 9, secured parties also have an obligation to comply with certain statutory requirements. Such requirements are designed to protect obligors and generally provide that the time, place and/or manner of exercising such remedy must be commercially reasonable, that sufficient advance notice is provided to the relevant obligor and that certain other creditors who have an interest in the collateral are given adequate notice where such sale process involves a public sale or auction.

6.2 Foreign Law and Jurisdiction

Generally speaking, New York courts will permit parties to a loan agreement to select a particular foreign law to govern their contract. Notwithstanding this general rule, where the choice of law conflicts with public policy or there is no reasonable basis for the parties to choose such law to govern their contract (ie, the law selected has no real relationship to the parties or the transaction), the courts may decline to enforce the governing law selected by the parties.

In terms of conflict of laws rules, New York's rules will generally uphold foreign forum selection clauses so long as the jurisdiction selected by the parties has a reasonable relationship to the transaction – more specifically, a significant portion of the agreement was negotiated, or the agreement was substantially performed, in such jurisdiction.

In cases involving foreign states, the Foreign Sovereign Immunities Act will permit a waiver of immunity either explicitly or by implication.

6.3 Foreign Court Judgments

Subject to certain conditions being observed (including due process requirements and reciprocity), New York courts will generally rec-

ognise and enforce the judgments of foreign courts. However, although uniform laws have been adopted by many US states, when recognition and enforcement of foreign judgments is concerned, there is still significant diversity between the states when dealing with procedural and substantive considerations.

6.4 A Foreign Lender's Ability to Enforce Its Rights

A foreign lender's ability to enforce its rights under a loan or security agreement will depend on the facts and circumstances of each case.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

Automatically upon the filing of a petition to commence insolvency proceedings under the United States Bankruptcy Code, an "automatic" stay comes into effect, prohibiting perfection of interests, termination of contracts, and enforcement activities by creditors, with few exceptions. This stay prevents the proverbial creditor "race to the courthouse" and provides the debtor with a "breathing spell," typically to organise a sale or a plan of reorganisation or liquidation.

Lenders' enforcement rights are replaced with rights in the bankruptcy case, and lenders may seek repayment from sale proceeds or estate distributions, which may take a variety of forms, including payment of cash or equity, reinstatement of debt, and issuance of replacement obligations. In chapter 11, the reorganisation chapter of the Bankruptcy Code, individual creditors are entitled to recover the liquidation value of their claims regardless of how similar creditors placed in the same class vote. Classes of creditors may be bound to a plan when 2/3 in amount and more than 50% in number of the class approve. Class approval is not required however if the "cram down" standards are met, which generally prohibit distributions to junior creditors or equity where senior dissenting classes are impaired and require that secured creditors either receive their collateral, its proceeds or its "indubitable equivalent" value, or secured replacement notes. Chapter 7, the liquidation chapter of the Bankruptcy Code, has its own distribution rules.

Secured creditors also have the right to credit bid in a sale of their collateral, must consent to the use of cash collateral unless their security interest is "adequately protected", and may seek adequate protection against diminution of the value of their collateral, or relief from the automatic stay for cause.

7.2 Waterfall of Payments

The Bankruptcy Code recognises certain rights of lien and payment priority, which are set out in broad strokes below.

First, secured creditors are paid from the value of their collateral, subject to estate claims for the costs of maintaining such collateral.

Then come administrative claims, priority claims, general unsecured claims (including deficiency claims of undersecured creditors) and equity, in that order.

Administrative claims include expenses of administering the estate, operating the business on a post-petition basis, and certain statutorily designated items (eg, claims for goods delivered within the twenty days before the petition date and claims arising from a failure of adequate protection).

"Priority" general unsecured claims include, among other things, certain taxes and employee claims. Administrative and priority claims must be paid under a plan (some priority claims can be paid over time), and certain priorities apply within these categories.

7.3 Length of Insolvency Process and Recoveries

Case length depends on a variety of factors, with the most important being the level of advance planning and creditor agreement at the petition date.

In chapter 11 cases, if creditors are solicited on a "prepackaged" plan and certain notice periods are permitted to run prior to filing the case, a bankruptcy case can be as short as a day. More typically, prepackaged bankruptcies take 45-60 days from the petition date.

"Prearranged" plans, where requisite creditors have largely agreed to a plan framework but have not been solicited before the case is filed can also be expedited and completed within two to three months.

If a plan must be formulated after the filing, three to six months is more typical, and cases with more complex issues, litigation, and lack of consensual resolution can take significantly longer. There is no time limit for exiting bankruptcy, but the debtor may not maintain the exclusive right to file a plan for longer than 18 months after the petition date and or the exclusive right to solicit a plan for more than 20 months after the petition date. Cases may also be dismissed or converted to liquidation, particularly where there is no prospect of reorganisation.

Chapter 11 effectively preserves going-concern value and sizeable enterprises frequently reorganise successfully using this process. Additionally, there is a mature investor base specialised in acquiring distressed companies (or their debt or assets), which aids in supporting value. Companies that cannot reorganise may be liquidated under chapter 7.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Where the borrower can obtain requisite consents to restructure debt or other contractual obligations, parties may restructure without proceedings. For example, borrowers and issuers may seek to exchange or amend existing debt to allow for covenant relief, extended payment terms or payment relief, and sometimes simultaneously solicit consents for a pre-packaged bankruptcy to be filed if requisite consents are not obtained. Carrots can be offered as well, such as improvements in collateral, guarantees, or other terms. Some deals involve incumbent lenders providing additional capital or other concessions to participating lenders in exchange for improvements in their priority position relative to other lenders or by lending against separate collateral. The ability under many agreements to effectuate such transactions without unanimous consent allows the architects of these transactions to propose coercive terms that leave non-participating lenders in a worse collateral, guaranty and/or covenant position, or to exclude some lenders from the opportunity to participate altogether.

For capital structures with a limited number of secured creditors and no need to restructure operations, consensual foreclosure or non-juridical foreclosure under Article 9 of the Uniform Commercial Code is relatively common. Some equity investors are also skilled at effectuating operational restructurings without the tools of bankruptcy.

7.5 Risk Areas for Lenders

Insolvency of an obligor creates risks of a change of control, degradation of the value of the obligors or their assets, and avoidance liability. In a bankruptcy, the company may be sold or transferred to creditors regardless of any constraints in loan documentation. In some scenarios, lenders, including secured lenders, may be given notes against the reorganised company. Additionally, lenders can be forced to accept virtually any distributional outcome that provides more than liquidation value if their class consents.

Any circumstance that further stresses the business, creates a forced-sale dynamic, or delays the process can diminish recoveries. Dilution by other creditors, including priming financing and related fees, additional equity financing provided under a rights offering and related fees (often in the form of rights to acquire equity at a discount), distributions to senior creditors under a low valuation, and necessary payments to other creditors, as well as the costs of the process, are all potential causes of lost value.

Finally, depending on the timing and circumstances of their loan, some lenders may be subject to risks of avoidance of rights transferred to them or obligations undertaken by the estate. The most typical of these is preference liability for transfers to unsecured or undersecured creditors within the 90 days preceding the case on account of antecedent debt. Fraudulent transfer liability generally arises in circumstances where a debtor is insolvent or inadequately capitalised and does not receive reasonably equivalent value for a transfer or obligation, or where the transfer is intended to hinder creditors.

8. Project Finance

8.1 Recent Project Finance Activity

The project finance structure continues to be utilised in the United States, including in the renewable energy and mining industries, as well as in connection with public-private partnerships, though there is increasing use of "hybrid" project finance-corporate finance structures, portfolios of projects and other varied structures. For example, in the renewable energy sector, portfolios of projects are frequently grouped into a single secured financing where all the assets of the group are pledged as collateral. In the mining space, while alternative sources of funding such as streaming, royalty and/or prepay contracts are now commonplace, a portion of the project funding typically is provided under a traditional project finance structure.

8.2 Public-Private Partnership Transactions

Increasingly, projects in the US have been successfully procured as P3s, relying on a "user fee" or an "availability payment" model and utilised in transportation, social infrastructure, water/wastewater, energy (particularly at universities) and telecom/broadband sectors. While availability payment structures remain the most consistently implemented model, the influx of infrastructure funds and private equity to the infrastructure sector has incentivised more value creation through risk or commercialisation.

The Infrastructure Investment and Jobs Act is expected to support P3s by authorising USD550 billion of new federal investments in infrastructure projects, renewing the TIFIA, RRIF and WIFIA loan programmes, doubling the cap on PAB issuance to surface transportation projects and directing the Secretary of Transportation to

establish a programme to enhance public entities' technical capacity to facilitate/evaluate P3s.

8.3 Governing Law

While project documents are not required to be governed by local law in project financings in the United States, they often are. Construction law is state-specific and therefore best practice often leads to signature of construction contracts under local law. Project documents use a mix of submission to jurisdiction to local courts and arbitration to resolve disputes based on the characteristics of the project, bargaining power of the parties and other factors.

8.4 Foreign Ownership

There are various state and federal laws that limit or prohibit the acquisition of US real property by non-resident foreign persons or entities that are controlled by non-resident foreign persons or impose reporting requirements on foreign owners of US real estate. Many of these laws apply only to mineral resources or to agricultural property. In advance of any acquisition of real estate, a purchaser is advised to review the relevant federal laws that apply to the prospective purchaser and the type of property being acquired and to consult with counsel in the state in which the property is located for an understanding of the relevant state laws.

8.5 Structuring Deals

The main issue to consider is whether the transaction will be a limited recourse deal or whether there will be a completion or other form of guaranty from the sponsor. This is particularly relevant in energy transition deals, such as hydrogen deals, where limited recourse financing may not be readily available. Another key issue when structuring the deal is to consider whether tax equity will be used to finance the project, as this will impact the terms of the project finance debt. The laws relevant to project companies vary depending on the sector and include both federal and state laws. In the case of the energy industry, key federal statutes include the Federal Power Act, the Public Utility Regulatory Policies Act of 1978 (PURPA) and the Public Utility Holding Company Act of 2005 (PUHCA).

8.6 Common Financing Sources and Typical Structures

In their simplest form, project financings are provided by syndicates of commercial banks, often together with development financial institutions (DFIs) and export credit agencies (ECAs) for projects in emerging markets. These financings are structured as senior secured financings with a first lien on all project assets/equity with limited or no recourse to the project sponsors. However, project financings are becoming increasingly complex multisource financings in which commercial bank and DFIs/ECA facilities combine with private equity, commodity trader, strategic investor (OEMs), governmental entity, project bond, ESG and streaming/royalty company funding in the form of debt, pre-paid forwards, leases, concessionary facilities, grants and hybrid debt/equity facilities, to name a few available investment instruments.

8.7 Natural Resources

A key issue with developing natural resource projects, particularly mining projects, in the US at this time is the difficulties inherent in the permitting process – both the length of time to permit these projects and the likely challenges to any permits issued (which can take years to resolve). A key consideration associated with downstream projects in the sector is the availability for the particular project of benefits afforded by the Inflation Reduction Act, whether in the form of tax credits, grants or concessionary loans. The availability of such benefits can

significantly enhance the financial feasibility of a project.

8.8 Environmental, Health and Safety Laws

The principal environmental laws include:

- the U.S. Comprehensive Environmental Response, Compensation and Liability Act, which governs the clean-up of soil and groundwater contamination and includes a "lender liability exemption";
- the Resource Conservation and Recovery Act, which requires the "cradle-to-grave" management and disposal of waste;
- the Clean Air Act;
- the Clean Water Act; and
- the Emergency Planning and Community Right-to-Know Act, which requires industry to report on the storage, use and release of certain chemicals to federal, state and local governments; these are overseen by the U.S. Environmental Protection Agency, or EPA.

The principal health and safety law is the U.S. Occupational Safety and Health Act which is overseen by the Occupational Safety and Health Administration, or OSHA.

Trends and Developments

Contributed by:
James A. Florack, Meyer C. Dworkin, Vanessa L. Jackson and Ledina Gocaj
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Davis Polk & Wardwell LLP delivers customised, innovative counsel to lenders and borrowers on their most important and complex financing transactions. The firm has been at the forefront of developments in the finance market for the past decade. A broad, market-leading practice led by 19 partners in New York and London provides advice to financial institutions, direct lenders and companies that anticipates market trends and protects against emerging vulnerabilities. Clients count on the firm's deep legal experience and commercial understanding in transactions that include leveraged and investment-grade acquisition financing, direct lending, bridge loans, structured finance, asset-based lending, and project and infrastructure finance. Clients benefit from Davis Polk's strong culture of cross-practice collaboration. The firm's finance lawyers work closely with capital markets lawyers on high-yield and investment-grade debt and as a team with its restructuring lawyers on financings, including DIP and exit facilities.

Authors

James A. Florack is co-head of Davis Polk's finance practice and leads the firm's Latin America finance practice. He advises clients on leveraged and investment-grade lending, structured finance, high-yield debt offerings and other capital markets transactions, with a particular focus on acquisition financings. James represents leading banks and corporations on both domestic and cross-border transactions. He is also called upon by clients in times of crisis or when facing unique challenges – including representing the US Treasury Department in implementing financings under the 2020 CARES Act. Jim is a Chambers Band 1 attorney in both the United States and Latin America.

Meyer C. Dworkin is a partner in Davis Polk's finance practice. He advises lenders and borrowers on a wide range of transactions including acquisition and other leveraged and investment-grade financings, asset-based financings, DIP and other distressed financings, and structured credit financings. His structured credit practice includes work on net asset value and capital call facilities and back-leverage transactions secured by liquid and illiquid debt, equity and other asset classes. Meyer represents funds and corporations in negotiating prime brokerage, derivatives and repurchase agreements, other trading and financing documentation and complex structured financial products. Meyer's work is recognised by Chambers.

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Davis Polk & Wardwell LLP

Vanessa L. Jackson is a partner in Davis Polk's finance practice. She represents financial institutions and corporate borrowers in a broad range of corporate finance transactions, including acquisition financings, asset-based lending, debt restructurings, spin-offs, working capital financings, debtor-in-possession financings and exit facilities. The Partnership for New York City admitted Vanessa to its 2022 Class of David Rockefeller Fellows and Crain's New York Business named her as one of 2022's "Notable Women in Law". Vanessa is recognised as an Up and Coming lawyer by Chambers USA.

Ledina Gocaj is a counsel in Davis Polk's financial institutions practice. She advises financial institutions and fintechs on variety of regulatory, supervisory and enforcement matters. She has counselled clients through government investigations and enforcement actions, board and executive effectiveness matters, large-scale remediation efforts, congressional hearings and issues related to digital assets. Previously, Ledina served as Senior Policy Advisor in the Office of the Chairman of the Federal Deposit Insurance Corporation, where she advised the Chairman and Deputy to the Chairman for Policy on a broad range of regulatory guidance, rule-makings, publications and economic research.

Davis Polk & Wardwell LLP

450 Lexington Avenue
New York
NY 10017
USA

Tel: +1 212 450 4000
Fax: +1 212 701 5800
Email: james.florack@davispolk.com
Web: www.davispolk.com

Contributed by: James A. Florack, Meyer C. Dworkin, Vanessa L. Jackson and Ledina Gocaj,
Davis Polk & Wardwell LLP

Implications of the Recent Banking Sector Turmoil for the Syndicated Loan Market

Spring 2023 saw three of the four largest bank failures in US history. After over a decade of significant reforms in the regulated financial sector, the US government was once again faced with balancing the trade-offs between the costs and consequences of providing unprecedented government backstops, on the one hand, and the risks of potential financial contagion on the other. All involved parties – including borrowers and lenders of syndicated credit facilities – faced immediate questions that for many years had been more theoretical than practical. Many of these challenges arose from the role of the Federal Deposit Insurance Corporation (FDIC) as receiver charged with resolving these failed banks.

Much has been written about the underlying causes of the failures of Silicon Valley Bank (SVB), Signature Bank (Signature) and First Republic Bank (FRB). While each has its own unique story and fact pattern, they have in common the backdrop of extraordinary fiscal and monetary policies at the time and "run on the bank" consequences hyper-charged by technological developments allowing almost instantaneous movement of a deposit base. Another unifying characteristic is their lack of similarity to the large bank failures of 2008. The issues related to mortgage origination at play in 2008 for even the largest banks no longer held true in 2023. Instead, in 2023, the failed banks' roles as agents and lenders in syndicates was at the fore.

For many borrowers and lenders who found themselves facing either the FDIC, as receiver, or a third-party purchaser from the receiver of the failed bank's assets and liabilities, navigating the contractual and statutory complexities was largely an issue of first impression. This article explores the interplay between the mechanics of an FDIC resolution and the customary contractual provisions of syndicated loan documents, and how that interaction has altered common assumptions regarding the application of those provisions in that environment. To the extent future failures of large banks reflect similar characteristics, consideration now of this interplay is even more essential for market participants.

Bank failures in spring 2023

A primary mandate of the FDIC is to insure deposits at depositary institutions. This insurance, of course, has limits, and amounts beyond those limits are not FDIC-insured. Depending on the nature of their customer and deposit base, many US banks have recently carried large balances of uninsured deposits. In 2022, the Federal Reserve initiated a steep escalation of the federal funds target rate from the near-zero rate environment that had prevailed since 2008, which subjected many portfolios of long-term fixed-rate assets to "mark-to-market" decreases. At the same time, depositors with large sums of uninsured deposits concerned about the impact of this revaluation on a bank's solvency, along with other depositors recognising an opportunity for higher return on their investment, could readily withdraw their balances away from the banks under pressure. When these withdrawals happened at scale – as they did at all three failed institutions (and as was threatened at others) – the result was a liquidity crisis. By 1 May 2023, the FDIC had taken into receivership a combined USD560 billion in assets from these three banks and announced its commitment to backstopping billions of dollars of otherwise uninsured deposits of SVB and Signature. Ultimately, the assets and liabilities of SVB were largely acquired by First Citizens Bank, those of Signature by Flagstar Bank and, finally, those of FRB by JPMorgan.

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Davis Polk & Wardwell LLP

Mechanics of FDIC receivership

A failing bank is most typically closed by its state or federal chartering authority. That regulator, in turn, appoints the FDIC as receiver. In this role, and as described in depth by John L. Douglas and Randall D. Guynn, the FDIC is required to choose a "least cost" resolution to the Deposit Insurance Fund, unless a systemic risk exception is invoked. The systemic risk exception was, in fact, invoked for SVB and Signature, but not for FRB. In most cases, the FDIC seeks bids from potential acquirers, each of which submits an offer for a specified combination of the failed bank's assets and liabilities. Historically, most banks taken into receivership by the FDIC have been smaller institutions for which the FDIC generally has time to work with potential bidders on a confidential basis for 90 days before the closure of the bank. In this typical scenario, the bank's closure and the related Purchase and Assumption Agreement (P&A Agreement) are announced contemporaneously at the close of business on a Friday. This model works well for smaller institutions, particularly ones with a retail-focused business, more limited inter-relationships with other financial institutions and perhaps a smaller institutional deposit base. SVB, Signature and FRB presented a different balance of considerations given their more complicated institutional client base and heightened risk of deposit flight. Those considerations have generally not been present in other large bank failures where the FDIC acted as receiver and, as a result, led to less awareness and opportunity to prepare for many market participants. For SVB and Signature, the FDIC took the interim step of first transferring substantially all assets and liabilities to a "bridge bank" to continue business-as-usual (to the extent possible) of the predecessor bank and to allow the FDIC additional time to conduct an orderly sales process. A bridge bank is a temporary national bank chartered by the Office of the Comptroller of the Currency (OCC) and operated by the FDIC to take over and maintain banking services for the customers of a failed bank. While the FDIC used a bridge bank for resolution of SVB and Signature, this interim step has not been the norm.

The failed bank acquisitions of 2023 were effected through P&A Agreements among the FDIC as receiver (for the failed bank or the bridge bank, if applicable), the FDIC in its corporate capacity and the acquiring bank. The assets and liabilities not purchased by the acquiring bank pursuant to the P&A Agreement remained with the FDIC. In its role as receiver, the FDIC was charged with liquidating these remaining assets, with the goal of maximising recoveries for the benefit of claimants against the receivership. Importantly, the FDIC executed the P&A Agreements with the support of its "superpowers", including the power to transfer assets and liabilities from the failed or bridge bank to the acquirer without regard to otherwise binding contractual restrictions on transfer, including contractually required consents of the borrower, agent or other parties to a loan agreement subject to transfer. In the case of SVB, the bridge bank was preceded by a deposit insurance national bank (often referred to as a DINB), which is similar to, but more limited in operations than, a bridge bank and primarily functions to provide depositors access to their insured deposits. In support of a resolution, the FDIC also has the power to disaffirm or repudiate any contract or lease if it determines that the contract would be burdensome. Likewise, it has the right to enforce contractual rights without regard to provisions that purport to terminate or alter those rights upon the institution of receivership proceedings with respect to the affected bank – so-called ipso facto clauses.

Counterparties to failed institutions

A cornerstone of the receivership process is that, once a bank has failed, creditors of the failed bank have privity with either the FDIC, as receiver, or the acquirer. Speed is of the essence in a taking a bank into receivership, given the damage to the failed institution and the risks to counterparties and the financial system. The FDIC, thus, seeks to act as expeditiously as practicable to obtain bids, negotiate a P&A Agreement and announce a go-forward plan to restore depositor and market confidence. One consequence of this necessarily frenetic pace is that the terms of P&A Agreements – in particular the precise list of assets and liabilities transferred to the acquiring bank – may be less precise than in a similar agreement executed in a more typical, non-distressed bank acquisition. The heightened urgency of the events of 2023 only underscores that point. Working through the final allocation of assets and liabilities often takes considerable time and effort by the parties, and typically requires extensive and commercial co-operation among the FDIC, the acquiring institution and affected market participants, including lenders and borrowers. Liabilities of the failed bank may be transferred piecemeal. The precise contours of the pieces left behind in the receivership will depend upon the applicable P&A Agreement and will often not be resolved quickly, with affected market participants sometimes surprised at the resolution.

Impact on syndicated credit facilities

Most modern syndicated loan facilities include extensive provisions regarding the ability of a lender to assign or otherwise transfer its rights and liabilities under the credit agreement. These agreements also contain detailed terms and conditions regulating the relationship between an individual lender and the rest of the syndicate, including the agents administering the facility and individual lenders providing "syndicate backstopped" credit extensions, such as letters of credit and swing-line loans. They also contain certain other features that may be impacted by the failure of one of their relationship banks.

Defaulting lender

If a lender – here, a regulated bank – fails, the first-order question of that failure is whether the failed bank will continue to honour its contractual funding and other obligations. If the facility is a fully funded term loan, those obligations may principally be a backstop indemnity of the agents. But, if it is a revolving credit facility or an as-yet unfunded "delayed-draw" term loan commitment, those obligations may include funding future loans, issuing letters of credit (for a revolver) and satisfying other syndicate-level obligations as a lender. Credit facilities have long anticipated and addressed the possibility that a lender may not perform, or may not be able to perform, its obligations through the inclusion of customary "defaulting lender" provisions. Under most credit agreements a "defaulting lender" is defined to include, in addition to one that simply fails to perform its funding obligations, a lender that is subject to insolvency or receivership proceedings. Credit agreements permit borrowers to exercise various remedies against a defaulting lender, including redirecting unused commitment and other fees otherwise payable to such lenders (on the grounds that commitments of the defaulting lenders are not meaningfully "available"), "yanking" such lenders by forcing them to assign their loans and commitments to a new or existing syndicate member and stripping their ordinary course voting rights. These actions are, collectively, intended to ensure that the borrower maintains ready, regular and full access to its revolving commitments and credit facility, and to limit the adverse effect on the other lenders and agents. The credit agreement will typically

contain similar provisions permitting lenders and a borrower to replace administrative and collateral agents under these circumstances to, again, assure the continuing function of a credit facility in accordance with its terms. This latter right takes on particular significance if a large syndicate of lenders is required to initially fund loans to the administrative agent who, in turn, transfers the collected amounts to the borrower. Where an agent is subject to a receivership, the other lenders may hesitate to send funds to the agent as intermediary if they are uncertain of if and when the funds will be transferred to the ultimate borrower. The combination of a clear contractual direction (here, lenders make funds available through an account of the administrative agent) and an uncertain legal or practical result may inhibit even the most straightforward effort by a borrower to access funds under its loan facility.

But having a contractual right and being able to enforce it can be two separate things. In the recent bank failures, borrowers and other lenders were, in practice, unable to avail themselves of defaulting lender rights and remedies, with many concluding that exercise of these ipso facto clauses was effectively stayed by the laws governing the FDIC receivership process. In the immediate aftermath, borrowers – and non-defaulting lenders and agents – were uncertain as to the ongoing operating status of the receiverships and bridge banks, including their continuing undertaking and ability to fund commitments and perform critical agency functions, yet unable to exercise the defaulting lender remedies.

In this case, the FDIC confirmed that the receiverships and bridge banks would comply with all lending and agency commitments, while strongly advising lenders and borrowers against taking any actions detrimental to the value of the failed bank assets. The uncertainty arising from the FDIC's initial silence on the treatment of SVB's assets and deposits in receivership as well as the inability of borrowers and lenders to exercise their contractual defaulting lender remedies (including with respect to SVB as agent under many facilities), however, surprised many and caused much confusion in the lending market.

Transfer restrictions

A second impact of the banking turmoil on credit facilities was the ability of the FDIC – using its "superpowers" – to assign bank assets and liabilities (including unfunded revolving commitments) first to the FDIC as receiver, to a bridge bank, and ultimately to an acquirer, without obtaining contractually required consents. A fundamental tenet of the syndicated loan market has long been that a borrower maintains tight controls over its – especially revolving – lender syndicates to ensure that only "friendly" and creditworthy institutions have access to their detailed financing reporting, the ability to exercise remedies upon a default and an obligation to fund loans subject to the contractual terms and conditions of their agreement. In particular, credit agreements almost always provide the borrower with a consent right over assignments of loans and revolving commitments, subject to limited exceptions. The FDIC's right to override this strict consent requirement in transferring assets and liabilities under a P&A Agreement resulted in borrowers, as well as agents and lenders, facing – without any notice, consent or objection rights – the credit risk of institutions with which they may have had no previous association. First Citizens Bank and Flagstar Bank (and certainly JPMorgan Chase) have, in practice, funded their commitments, acted as administrative agent and otherwise complied with the contractual obligations they acquired. While the

actual fallout has thus been limited, the practical limitations on a borrower's control of its lending relationships in the context of a receivership process was an unexpected consequence to many.

Other issues

There were a number of other issues relating to credit facilities that arose from the bank failures. First, issuers of letters of credit under revolving facilities are often granted the right to refuse to issue new letters of credit to the extent there is a defaulting lender in the syndicate. While, as noted above, a borrower may generally be prohibited from exercising remedies directly against a lender as a result of an FDIC receivership, whether an issuing bank is similarly constrained by the FDIC from exercising rights against the borrower that arise as a result of the affected lender's receivership remains an open question. Second, the time between the announcement of SVB's closure and the decision to insure all deposits raised the question whether the uninsured portion of any deposits prior to any transfer to an acquirer could be viewed as unrestricted, and a "permitted" investment. Many credit agreements allow a borrower to "net" (or deduct) unrestricted cash and cash equivalents against (or from) outstanding indebtedness in computing leverage ratio covenants and conditions. These leverage ratios – which are used in syndicated (primarily leveraged) credit facilities both as a condition to the incurrence or making of debt, lien, investments and restricted payments as well as the basis of financial maintenance covenants – measure the ratio of the outstanding indebtedness of the borrower and its subsidiaries (either in total or a specific type or ranking) to the consolidated EBITDA of the borrower group. While not expressly addressed in credit agreements, lenders were forced to consider whether uninsured deposits at the receiver should be viewed as unrestricted and available as a "cash equivalent". Similarly, agreements often impose limits on a borrower's investment activities, but generally permit deposit accounts with banks with a particular credit rating. Failures of the type seen in 2023 usually occur before a bank's credit rating is downgraded, but that downgrade happens quickly after the problem is recognised. And, where the deposit is transferred to a bridge bank, even on an interim basis, that bridge bank may not have a rating at all or otherwise qualify as the issuer of a permitted investment.

Implications for the syndicated loan market

One outcome of the banking turmoil of 2023 is that it has provided market participants with a better understanding of the FDIC receivership process and greater sensitivity to the superpowers of the FDIC, including the resulting impact on the terms and conditions of and remedies under credit facilities. An open question is what the longer term implications to the syndicated lending market will arise from these new realisations.

One potential reaction of borrowers is to continue – or even accelerate – recent trends to broaden their lending relationships from banks to private credit and other institutional lenders. While, historically, such lenders were far smaller and less creditworthy than banks – and unable to provide multi-currency loans, letters of credit and other customary banking products – the private direct lending universe has grown enormously over the past few years in size, participants and the array of traditional "bank" products offered. The largest private credit institutions now rival many banks in lending capacity and have developed the infrastructure to provide (directly or in collaboration with a third party) many of the same lending products as banks. Importantly, a failure of these institutions will generally not be subject to FDIC supervision and resolution and the resulting restrictions, limitations and

rights discussed above. In practice, many failed private credit lenders would likely be subject to the US Bankruptcy Code or another regime that would likely include many of the same "stay" and other prohibitions on limiting or altering the debtor's rights or exercising remedies against it. These processes – at least for Chapter 11 of the Bankruptcy Code – are, however, generally better understood by market participants than FDIC receivership/bridge bank mechanics have proved to be.

Conclusion

The bank failures of 2023 have brought into focus the interaction of the FDIC receivership and resolution process with some common features of syndicated loan documents. Market participants will want to re-examine the effectiveness of some of these provisions and consider alternative approaches to achieving the desired result. Although the FDIC had executed hundreds of P&A Agreements over the past two decades, the profile of these particular failed banks – including their size, product offering and lack of any meaningful warning signs – underscored the strength of the FDIC's statutory superpowers over a broad range of contractual counterparties and agreements. While lenders and borrowers under syndicated credit facilities will certainly seek to address the issues highlighted in 2023, the next failure or stress at a large banking organisation, will, without doubt, test a new set of assumptions for the syndicated loan and other markets.

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