



# ICLG

The International Comparative Legal Guide to:

# Securitisation 2014

**7th Edition**

A practical cross-border insight into securitisation work

Published by Global Legal Group, with contributions from:

A&L Goodbody

Accura Advokatpartnerselskab

Advokatfirmaet Thommessen AS

Advokatfirman Vinge KB

Ali Budiardjo, Nugroho, Reksodiputro

Ashurst LLP

Association for Financial Markets in Europe

Berwin Leighton Paisner LLP

Bofill Mir & Álvarez Jana Abogados

Bonn & Schmitt

Brodies LLP

Cass Legal

Chiomenti Studio Legale

Cleary Gottlieb Steen & Hamilton LLP

Dave & Girish & Co.

Deloitte & Touche LLP

Drew & Napier LLC

Estudio Beccar Varela

Fellner Wratzfeld & Partners

Freshfields Bruckhaus Deringer LLP

Haxhia & Hajdari Attorneys At Law

J.D. Sellier + Co.

King & Wood Mallesons

Latham & Watkins LLP

LCS & Partners

Levy & Salomão Advogados

Loyens & Loeff N.V.

Nishimura & Asahi

Patton, Moreno & Asvat

Pestalozzi Attorneys at Law Ltd

Schulte Roth & Zabel LLP

Shearman & Sterling LLP

Torys LLP

Uría Menéndez Abogados, S.L.P.

Vieira de Almeida & Associados – Sociedade de Advogados, R.L.

Weil, Gotshal & Manges

**GLG**

Global Legal Group

# GLG

Global Legal Group

## Contributing Editor



Mark Nicolaides,  
Latham & Watkins LLP

## Account Managers

Edmond Atta, Beth Bassett,  
Antony Dine, Susan Glinska,  
Dror Levy, Maria Lopez,  
Florjan Osmani, Paul Regan,  
Gordon Sambrooks, Oliver  
Smith, Rory Smith

## Sales Support Manager

Toni Wyatt

## Sub Editors

Nicholas Catlin  
Amy Hirst

## Editors

Beatriz Arroyo  
Gemma Bridge

## Senior Editor

Suzie Kidd

## Global Head of Sales

Simon Lemos

## Group Consulting Editor

Alan Falach

## Group Publisher

Richard Firth

## Published by

Global Legal Group Ltd.  
59 Tanner Street  
London SE1 3PL, UK  
Tel: +44 20 7367 0720  
Fax: +44 20 7407 5255  
Email: info@glgroup.co.uk  
URL: www.glgroup.co.uk

## GLG Cover Design

F&F Studio Design

## GLG Cover Image Source

iStockphoto

## Printed by

Ashford Colour Press Ltd.  
April 2014

Copyright © 2014  
Global Legal Group Ltd.  
All rights reserved  
No photocopying

ISBN 978-1-908070-96-8  
ISSN 1745-7661

## Strategic Partners



## General Chapters:

1	<b>Documenting Receivables Financings in Leveraged Finance and High Yield Transactions</b> – James Burnett & Mo Nurmohamed, Latham & Watkins LLP	1
2	<b>CLO 3.0: The Impact of Regulations</b> – Craig Stein & Paul N. Watterson, Jr., Schulte Roth & Zabel LLP	8
3	<b>The What, Why and How of “Accounting for Securitisation under IFRS”</b> – William Fellows & Sherif Sakr, Deloitte & Touche LLP	14
4	<b>US Taxation, Including FATCA, of Non-US Investors in Securitisation Transactions</b> – David Z. Nirenberg, Ashurst LLP	19
5	<b>Debt Trading: A Practical Guide for Buyers and Sellers</b> – Paul Severs, Berwin Leighton Paisner LLP	29
6	<b>Securitisations in the Shadows of the New Capital Regime</b> – Bjorn Bjerke & Azad Ali, Shearman & Sterling LLP	35
7	<b>Time to Support High Quality Securitisation</b> – Richard Hopkin, Association for Financial Markets in Europe	42

## Country Question and Answer Chapters:

8	<b>Albania</b>	Haxhia & Hajdari Attorneys At Law: Artan Hajdari & Adi Brovina	44
9	<b>Argentina</b>	Estudio Beccar Varela: Damián F. Beccar Varela & Roberto A. Fortunati	54
10	<b>Australia</b>	King & Wood Mallesons: Anne-Marie Neagle & Ian Edmonds-Wilson	64
11	<b>Austria</b>	Fellner Wratzfeld & Partners: Markus Fellner	75
12	<b>Brazil</b>	Levy & Salomão Advogados: Ana Cecília Giorgi Manente & Fernando de Azevedo Peraçoli	84
13	<b>Canada</b>	Torys LLP: Michael K. Feldman & Jim Hong	94
14	<b>Chile</b>	Bofill Mir & Álvarez Jana Abogados: Octavio Bofill Genzsch & Daniela Buscaglia Llanos	105
15	<b>China</b>	King & Wood Mallesons: Roy Zhang & Ma Feng	115
16	<b>Denmark</b>	Accura Advokatpartnerselskab: Kim Toftgaard & Christian Sahlertz	127
17	<b>England &amp; Wales</b>	Weil, Gotshal & Manges: Rupert Wall & Jacky Kelly	138
18	<b>France</b>	Freshfields Bruckhaus Deringer LLP: Hervé Touraine & Laureen Gauriot	151
19	<b>Germany</b>	Cleary Gottlieb Steen & Hamilton LLP: Dr. Werner Meier & Michael Kern	163
20	<b>Hong Kong</b>	King & Wood Mallesons: Paul McBride & Michael Capsalis	178
21	<b>India</b>	Dave & Girish & Co.: Mona Bhide	190
22	<b>Indonesia</b>	Ali Budiardjo, Nugroho, Reksodiputro: Freddy Karyadi & Novario Asca Hutagalung	201
23	<b>Ireland</b>	A&L Goodbody: Peter Walker & Jack Sheehy	210
24	<b>Italy</b>	Chiomenti Studio Legale: Francesco Ago & Gregorio Consoli	222
25	<b>Japan</b>	Nishimura & Asahi: Hajime Ueno	234
26	<b>Luxembourg</b>	Bonn & Schmitt: Alex Schmitt & Andreas Heinzmann	248
27	<b>Netherlands</b>	Loyens & Loeff N.V.: Mariëtte van 't Westeinde & Jan Bart Schober	260
28	<b>Nigeria</b>	Cass Legal: Adebajo Odotola	275
29	<b>Norway</b>	Advokatfirmaet Thommessen AS: Tore Mydske & Kristoffer Hegdahl	284
30	<b>Panama</b>	Patton, Moreno & Asvat: Ivette Elisa Martínez Sáenz & Ana Isabel Díaz Vallejo	294
31	<b>Portugal</b>	Vieira de Almeida & Associados – Sociedade de Advogados, R.L.: Paula Gomes Freire & Benedita Aires	305
32	<b>Scotland</b>	Brodies LLP: Bruce Stephen & Marion MacInnes	318

Continued Overleaf

Further copies of this book and others in the series can be ordered from the publisher. Please call +44 20 7367 0720

## Disclaimer

This publication is for general information purposes only. It does not purport to provide comprehensive full legal or other advice. Global Legal Group Ltd. and the contributors accept no responsibility for losses that may arise from reliance upon information contained in this publication. This publication is intended to give an indication of legal issues upon which you may need advice. Full legal advice should be taken from a qualified professional when dealing with specific situations.

## Country Question and Answer Chapters:

33	<b>Singapore</b>	Drew & Napier LLC: Petrus Huang & Ron Cheng	327
34	<b>Spain</b>	Uría Menéndez Abogados, S.L.P.: Ramiro Rivera Romero & Jorge Martín Sainz	339
35	<b>Sweden</b>	Advokatfirman Vinge KB: Stefan de Hevesy & Albert Wållgren	355
36	<b>Switzerland</b>	Pestalozzi Attorneys at Law Ltd: Oliver Widmer & Urs Klöti	364
37	<b>Taiwan</b>	LCS & Partners: David Chuang & Grace Ku	376
38	<b>Trinidad &amp; Tobago</b>	J.D. Sellier + Co.: William David Clarke & Donna-Marie Johnson	387
39	<b>USA</b>	Latham & Watkins LLP: Lawrence Safran & Kevin T. Fingeret	398

---

## EDITORIAL

---

Welcome to the seventh edition of *The International Comparative Legal Guide to: Securitisation*.

This guide provides the international practitioner and in-house counsel with a comprehensive worldwide legal analysis of the laws and regulations of securitisation.

It is divided into two main sections:

Seven general chapters. These are designed to provide readers with a comprehensive overview of key securitisation issues, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in securitisation laws and regulations in 32 jurisdictions.

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

Special thanks are reserved for the contributing editor, Mark Nicolaides of Latham & Watkins LLP, for his invaluable assistance.

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

The *International Comparative Legal Guide* series is also available online at [www.iclg.co.uk](http://www.iclg.co.uk).

Alan Falach LL.M.  
Group Consulting Editor  
Global Legal Group  
[Alan.Falach@glgroup.co.uk](mailto:Alan.Falach@glgroup.co.uk)

---

# Documenting Receivables Financings in Leveraged Finance and High Yield Transactions

James Burnett



Mo Nurmohamed



Latham & Watkins LLP

### Introduction

Including a receivables securitisation tranche when financing (and refinancing) highly leveraged businesses that generate trade receivables may be useful for several reasons. First and foremost, securitisation financings can generally be obtained at a much lower overall cost to the corporate group. Second, securitisation financings typically do not impose as extensive a package of operational restrictions on the group compared with those found in leveraged finance facility agreements. Finally, many companies engaged in securitisation transactions claim that it helps them improve the efficiency of their underlying business by focussing management attention on the actual performance of customer relationships (e.g. invoice payment speed and volume of post-sale adjustments).

These benefits notwithstanding, receivables securitisation tranches are less common in European leveraged buyouts than they are in comparable US transactions, due in part to the cross-border nature of European leveraged buyouts and the advantages for creditors of taking security over receivables (as compared with other asset classes) in certain jurisdictions. In some cases, private equity sponsors may not have enough information about the target group before an acquisition is completed to recognise the benefits of a securitisation tranche at the time the acquisition financing is negotiated.

In leveraged finance facility agreements and high yield bond indentures, affirmative and negative covenants restrict the operations of the borrower / issuer and all or certain of its significant (i.e. “restricted”) subsidiaries in a complex and wide-ranging manner. This chapter discusses the manner in which such covenants would need to be modified in order for a borrower / issuer to be able to enter into a receivables securitisation without needing to obtain specific lender or bondholder consent, which is often a costly and challenging process, if at all possible. Since bondholders are typically a disparate class of creditors, obtaining the requisite bondholder consent to amend a high yield bond indenture to permit receivables securitisation may be difficult and expensive in practice, so it is imperative that appropriate carve-outs are included in the high yield bond indenture at the outset. Although this chapter describes one set of modifications, there are, of course, various means of achieving the same objectives and the transaction documentation must be analysed carefully in each case to determine what exactly is required. This chapter also discusses some of the key negotiating issues involved in negotiating and documenting such covenant modifications.

Once appropriate covenant carve-outs permitting a trade receivables securitisation have been agreed, the securitisation itself

can then be structured and documented. Each of the country chapters in the latter part of this guide provides a summary of the issues involved in executing a securitisation in that country.

### Typical Transaction Structure

Trade receivables are non-interest bearing corporate obligations typically payable up to 90 days following invoicing. They arise following the delivery of goods or the rendering of services by a company to its customers. As long as a receivable is legally enforceable and not subject to set-off, and satisfies certain other eligibility criteria specific to each transaction, the company to which the receivable is owing can raise financing against it.

One popular form of receivables financing, asset-based lending (ABL), is structured as a loan to a company secured by the receivables owing to such company. ABL transactions, although popular, have the drawback of exposing ABL lenders to all of the risks of the borrowing company’s business – risks which may lead to the company’s insolvency and (at least) delays in repayment of the ABL lenders.

An alternative form of receivables financing, discussed below, is a “securitisation” of the receivables. A securitisation involves the outright sale of receivables by a company to a special purpose vehicle (SPV), usually a company but also possibly a partnership or other legal entity. The purchase price of receivables will generally equal the face amount of the receivables minus, in most cases, a small discount to cover expected losses on the purchased receivables and financing and other costs of the SPV. The purchase price will typically be paid in two parts: a non-refundable cash component paid at the time of purchase with financing provided to the SPV by senior lenders or commercial paper investors; and a deferred component payable out of collections on the receivables. In some jurisdictions, the deferred component may need to be paid up front (e.g. to accomplish a “true sale” under local law), in which case the SPV must incur subordinated financing, usually from a member of the selling company’s group, to finance that portion of the purchase price. The SPV will grant security over the receivables it acquires and all of its other assets to secure repayment of the financing incurred by it to fund receivables purchases.

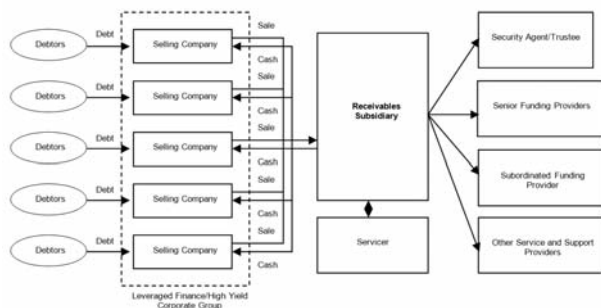
The SPV will be structured to have no activities and no liabilities other than what is incidental to owning and distributing the proceeds of collections of the receivables. The SPV will have no employees or offices of its own; instead, the SPV will outsource all of its activities to third parties pursuant to contracts in which the third parties agree not to make claims against the SPV. While the SPV purchaser will often be established as an “orphan company”, with the shares in the company held in a charitable trust, rather than

by a member of the target group, in certain jurisdictions and depending on the particular deal structure, it may be necessary to establish an initial purchaser of receivables that is incorporated as a member of the group (which may then on-sell the receivables to an “orphan” SPV).

Collection of the receivables will generally be handled by the selling company or another member of the group pursuant to an outsourcing contract until agreed trigger events occur, at which point a third party servicer can be activated. By these and other contractual provisions the SPV is rendered “bankruptcy remote” and investors in the securitisation are as a result less likely to suffer the risks of the insolvency of the borrower of the securitisation debt.

From collections, the SPV will pay various commitment fees, administration fees and interest to its third party suppliers and finance providers. All payments are made pursuant to payment priority “waterfalls” that govern the order in which parties are paid. Typically, there are separate waterfalls for distributions made prior to enforcement and for distributions made after enforcement commences.

The structure of a typical trade receivables securitisation transaction is as follows:



## Documentation Provisions

In light of the foregoing, we describe below the provisions necessary to permit a trade receivables securitisation under typical leveraged finance documentation. In summary, the relevant documentation will need to include several framework definitions describing the general terms of the anticipated securitisation transaction and several carve-outs from the restrictive covenants to which the relevant borrower / issuer would otherwise be subject. We address each in turn below.

## Descriptive Definitions

The following descriptive definitions will need to be added to the relevant transaction documents to describe what is permitted and thus to provide reference points for the covenant carve-outs which follow. These definitions contain various limitations designed to strike a balance between the interests of the owners of the borrower / issuer, on the one hand, who desire to secure the receivables financing on the best possible terms, and the interests of the senior lenders / bondholders, on the other hand, who do not want the terms of the securitisation financing to disrupt the borrower’s ability to repay their (usually much larger) loans or bonds in accordance with their terms. The definitions below are of course negotiable, and the exact scope of the definitions and related provisions will depend on the circumstances of the particular transaction and the needs of the particular group. In particular, where a business is contemplating alternate structures to a trade receivables securitisation, such as a

factoring transaction, certain slight modifications may be necessary to one or more of the definitions and related provisions described below.

The definitions below are tailored for a high yield indenture, but they can easily be modified for a senior facility agreement if desired.

“*Qualified Receivables Financing*” means any financing pursuant to which the Issuer or any of its Restricted Subsidiaries may sell, convey or otherwise transfer to (a) any Receivables Subsidiary (in the case of a sale, conveyance or transfer by the Issuer or any of its Restricted Subsidiaries) or (b) any other Person (in the case of a sale, conveyance or transfer by any Receivables Subsidiary), or may grant a security interest in, any accounts receivable (and related assets) in an aggregate principal amount equivalent to the Fair Market Value of such accounts receivable (whether now existing or arising in the future) of the Issuer or any of its Restricted Subsidiaries, and any assets related thereto; provided that (i) the covenants, events of default and other provisions applicable to such financing shall be customary for such transactions and shall be on market terms (as determined in good faith by the Issuer’s Board of Directors) at the time such financing is entered into, (ii) the interest rate applicable to such financing shall be a market interest rate (as determined in good faith by the Issuer’s Board of Directors) at the time such financing is entered into and (iii) such financing shall be non-recourse to the Issuer or any of its Restricted Subsidiaries except to a limited extent customary for such transactions.

“*Receivable*” means a right to receive payment arising from a sale or lease of goods or services by a Person pursuant to an arrangement with another Person pursuant to which such other Person is obligated to pay for goods or services under terms that permit the purchase of such goods or services on credit, as determined on the basis of applicable generally accepted accounting principles.

“*Receivables Assets*” means any assets that are or will be the subject of a *Qualified Receivables Financing*.

“*Receivables Fees*” means distributions or payments made directly or by means of discounts with respect to any participation interest issued or sold in connection with, and other fees paid to a Person that is not a *Restricted Subsidiary* in connection with, any *Qualified Receivables Financing*.

“*Receivables Repurchase Obligation*” means:

- any obligation of a seller of receivables in a *Qualified Receivables Financing* to repurchase receivables arising as a result of a breach of a representation, warranty or covenant or otherwise, including as a result of a receivable or portion thereof becoming subject to any asserted defense, dispute, off-set or counterclaim of any kind as a result of any action taken by, any failure to take action by or any other event relating to the seller; and
- any right of a seller of receivables in a *Qualified Receivables Financing* to repurchase defaulted receivables in order to obtain any VAT bad debt relief or similar benefit.

“*Receivables Subsidiary*” means a Subsidiary of the Issuer that does not engage in any activities other than in connection with a *Qualified Receivables Financing* and that is designated by the Board of Directors of the Issuer as a *Receivables Subsidiary*:

- of which no portion of the Indebtedness or any other obligations (contingent or otherwise) (i) is guaranteed by the Issuer or any other *Restricted Subsidiary* of the Issuer (excluding guarantees of obligations (other than the principal of, and interest on, Indebtedness) pursuant to *Standard Securitisation Undertakings*), (ii) has recourse to or obligates the Issuer or any other *Restricted Subsidiary* of the Issuer in any way other than pursuant to *Standard*

*Securitisation Undertakings, or (iii) subjects any property or asset of the Issuer or any other Restricted Subsidiary of the Issuer, directly or indirectly, contingently or otherwise, to the discharge or satisfaction thereof, (other than accounts receivable and related assets as provided in the definition of Qualified Receivables Financing) other than pursuant to Standard Securitisation Undertakings;*

- (b) *with which neither the Issuer nor any Restricted Subsidiary of the Issuer has any contract, agreement, arrangement or understanding other than on terms which the Issuer reasonably believes to be no less favourable to the Issuer or such Restricted Subsidiary than those that might be obtained at the time from Persons that are not Affiliates of the Issuer; and*
- (c) *to which neither the Issuer nor any Restricted Subsidiary of the Issuer has any obligation to maintain or preserve such Subsidiary's financial condition or cause such Subsidiary to achieve certain levels of operating results.*

*Any such designation by the Board of Directors of the Issuer shall be evidenced to the Trustee by filing with the Trustee a copy of the resolution of the Board of Directors of the Issuer giving effect to such designation and an Officer's Certificate certifying that such designation complied with the foregoing conditions.*

*"Standard Securitisation Undertakings" means representations, warranties, covenants, indemnities and guarantees of performance entered into by the Issuer or any Subsidiary of the Issuer which the Issuer has determined in good faith to be customary in a Receivables Financing, including those relating to the servicing of the assets of a Receivables Subsidiary, it being understood that any Receivables Repurchase Obligation shall be deemed to be a Standard Securitisation Undertaking.*

### Qualified Receivables Financing Criteria

In addition to the descriptive definitions above, the documentation may also set out certain criteria which the Qualified Receivables Financing would have to meet in order to be permitted. These criteria will often be transaction-specific or relate to certain commercial terms, in which case they may not be needed in addition to the requirements for market or customary provisions already incorporated into the descriptive definitions above (see "Key Issues" below). However, if required, these may include:

- minimum credit ratings (for underlying debt or the securities issued pursuant to the securitisation);
- conditions as to who may arrange the securitisation;
- notification obligations in respect of the main commercial terms;
- a requirement to ensure representations, warranties, undertakings and events of defaults / early amortisation events are no more onerous than the senior financing;
- a cap on the aggregate amount of indebtedness that can be outstanding at any one time under a receivables securitisation; and / or
- other economic terms (e.g. a cap on the weighted average cost of interest and third party credit enhancement payable).

### Covenant Carve-outs

In a typical senior facility agreement or high yield indenture, the securitisation transaction must be carved out of several covenants, described in further detail below. In summary, carve-outs will need to be created for the following restrictive covenants:

- Asset sales / disposals.
- Indebtedness.

- Liens / negative pledge.
- Restricted payments.
- Limitations on restrictions on distributions from restricted subsidiaries.
- Affiliate transactions / arm's length terms.
- Financial covenants (in the case of facility debt only).

### Limitation on asset sales / disposals

Typically in a leveraged facility agreement, the relevant borrower may not, and may not permit any of its subsidiaries to, sell, lease, transfer or otherwise dispose of assets (other than up to a certain permitted value), except in the ordinary course of trading or subject to certain other limited exceptions. Similarly, in a typical high yield indenture, the issuer may not, and may not permit any of its "restricted subsidiaries" to make any direct or indirect sale, lease (other than an operating lease entered into in the ordinary course of business), transfer, issuance or other disposition, of shares of capital stock of a subsidiary (other than directors' qualifying shares), property or other assets (referred to collectively as an "Asset Disposition"), unless the proceeds of such disposition are applied in accordance with the indenture (which will regulate how the net disposal proceeds must be invested).

In connection with a Qualified Receivables Transaction the relevant borrower and its restricted subsidiaries will sell receivables and those sales would otherwise be caught by such a restriction. Thus, the relevant documentation should contain an explicit carve-out, typically in the case of a high yield indenture from the definition of "Asset Disposition", along the following lines:

*(--) sales or dispositions of receivables in connection with any Qualified Receivables Financing.*

A similar carve-out can be included in the restrictive covenant relating to disposals in a loan facility agreement, or in the definition of "Permitted Disposal" or "Permitted Transaction", where applicable.

### Limitation on indebtedness

In a leveraged facility agreement the relevant borrower group is often greatly restricted in its ability to incur third party financial indebtedness other than in the ordinary course of its trade (again, often subject to a permitted debt basket and certain other limited exceptions). In a high yield indenture, the issuer and its restricted subsidiaries are normally restricted from incurring indebtedness other than "ratio debt" (e.g. when the fixed charge cover and / or leverage ratio of the group is at, or below, a specified level), subject to limited exceptions. In a high yield indenture, the term "Indebtedness" typically covers a wide variety of obligations.

A receivables subsidiary in connection with a qualified receivables transaction will incur various payment obligations that would otherwise be caught by such a restriction, particularly if the financing is raised in the form of a secured loan made to the receivables subsidiary. Thus, if a borrower / issuer desires to retain the ability to continue to obtain funding under a receivables securitisation even if the leverage of the group is too high to permit the incurrence of third party financings (or if the permitted debt basket is insufficient), the relevant documentation should contain an explicit carve-out from the indebtedness restrictive covenant along the following lines:

*(--) indebtedness incurred by a Receivables Subsidiary in a Qualified Receivables Financing.*

Alternatively, one could exclude the securitisation transaction from the definition of "Indebtedness" directly:

*The term "Indebtedness" shall not include . . . (--) obligations and contingent obligations under or in respect of Qualified Receivables Financings.*

It should be noted that an exclusion from “Indebtedness” may have an impact on other provisions such as the cross default or financial covenants so it should therefore be considered carefully in each of the different contexts in which it would apply (see also “Financial Covenants” below).

Subject to the same considerations, a similar carve-out can be included in the restrictive covenant relating to the incurrence of Financial Indebtedness in a loan facility agreement, or in the definition of “Permitted Financial Indebtedness” or “Permitted Transaction”, where applicable.

#### **Mandatory prepayment of other debt from the proceeds of securitisations**

In a leveraged facility agreement, the carve-outs from disposals and “Indebtedness” described above may be subject to a cap, above which any such amounts are either prohibited absolutely or subject to mandatory prepayment of other debt. Whether, and to what extent, the proceeds of securitisations should be used to prepay debt can often be heavily negotiated. The business may wish to use such proceeds for general working capital purposes while lenders would be concerned at the additional indebtedness incurred by a borrower group which may already be highly leveraged.

If some form of mandatory prepayment is agreed, this will often be limited to the initial proceeds of the securitisation so that the borrower is not required to keep prepaying as new receivables replace existing receivables. A simple way to incorporate this into the loan documentation would be to carve out ongoing proceeds from the proceeds which are required to be prepaid:

*“Excluded Qualified Receivables Financing Proceeds” means any proceeds of a Qualified Receivables Financing to the extent such proceeds arise in relation to receivables which replace maturing receivables under that or another Qualified Receivables Financing;*

*“Qualified Receivables Financing Proceeds” means the proceeds of any Qualified Receivables Financing received by any member of the Group except for Excluded Qualified Receivables Financing Proceeds and after deducting:*

- (a) *fees, costs and expenses in relation to such Qualified Receivables Financing which are incurred by any member of the Group to persons who are not members of the Group; and*
- (b) *any Tax incurred or required to be paid by any member of the Group in connection with such Qualified Receivables Financing (as reasonably determined by the relevant member of the Group, on the basis of existing rates and taking into account any available credit, deduction or allowance) or the transfer thereof intra-Group,*

to the extent they exceed, in aggregate for the Group, (--) in any financial year.

#### **Limitation on liens / negative pledge**

In a leveraged facility agreement, the borrower and other members of the group will be restricted from creating or permitting to subsist any security interest over any of their assets, other than as arising by operation of law or in the ordinary course of trade (again, often subject to a permitted security basket and certain other limited exceptions). Similarly, in a typical high yield indenture, an issuer may not, and may not permit any of its restricted subsidiaries to, incur or suffer to exist, directly or indirectly, any mortgage, pledge, security interest, encumbrance, lien or charge of any kind (including any conditional sale or other title retention agreement or lease in the nature thereof) upon any of its property or assets, whenever acquired, or any interest therein or any income or profits therefrom (referred to collectively as “Liens”), unless such Liens also secure the high yield debt (either on a senior or equal basis, depending on the nature of the other secured debt). As with

leveraged loan facilities, typically, there is a carve-out for “Permitted Liens” that provide certain limited exceptions.

A receivables subsidiary in connection with a qualified receivables transaction will grant or incur various liens in favour of the providers of the securitisation financing that would otherwise be caught by the restriction, particularly if the financing is raised in the form of a secured loan made to the receivables subsidiary. Thus, the relevant documentation should contain an explicit carve-out from the lien restriction, along the lines of one or more paragraphs added to the definition of “Permitted Lien”:

*(--) Liens on Receivables Assets Incurred in connection with a Qualified Receivables Financing; and*

*(--) Liens securing Indebtedness or other obligations of a Receivables Subsidiary.*

A similar carve-out can be included in the negative pledge in a loan facility agreement, or in the definition of “Permitted Security” or “Permitted Transaction”, where applicable.

#### **Limitation on restricted payments**

Typically, in a leveraged facility agreement, the borrower and its subsidiaries may not make payments and distributions out of the restricted group to the equity holders or in respect of subordinated shareholder debt. Similarly, in a typical high yield indenture, an issuer may not, and may not permit any of its restricted subsidiaries to, make various payments to its equity holders, including any dividends or distributions on or in respect of capital stock, or purchases, redemptions, retirements or other acquisitions for value of any capital stock, or principal payments on, or purchases, repurchases, redemptions, defeasances or other acquisitions or retirements for value of, prior to scheduled maturity, scheduled repayments or scheduled sinking fund payments, any subordinated indebtedness (as such term may be defined).

A receivables subsidiary in connection with a qualified receivables financing will need to pay various fees that may be caught by this restriction. Thus, the relevant documentation should contain an explicit carve-out from the restricted payment covenant, along the following lines:

*(--) payment of any Receivables Fees and purchases of Receivables Assets pursuant to a Receivables Repurchase Obligation in connection with a Qualified Receivables Financing.*

A similar carve-out can be included in the restrictive covenants relating to dividends and restricted payments in a loan facility agreement, or in the definition of “Permitted Distribution” or “Permitted Transaction”, where applicable.

#### **Limitation on restrictions on distributions from restricted subsidiaries**

In a typical high yield indenture, the issuer may not permit any of its restricted subsidiaries to create or otherwise cause or permit to exist or to become effective any consensual encumbrance or consensual restriction on the ability of any restricted subsidiary to make various restricted payments, make loans, and otherwise make transfers of assets or property to such borrower / issuer.

A receivables subsidiary in connection with a qualified receivables financing will have restrictions placed on its ability to distribute cash to parties in the form of payment priority “waterfalls” that would otherwise usually be caught by such a restriction. Thus, the relevant document should contain an explicit carve-out from the limitation on restrictions on distributions, etc., along the following lines:

*(--) restrictions effected in connection with a Qualified Receivables Financing that, in the good faith determination of an Officer or the Board of Directors of the Issuer, are necessary or advisable to effect such Qualified Receivables Financing.*

**Limitation on affiliate transactions / arm's length terms**

Typically, in a leveraged facility agreement, the borrower and its subsidiaries will not be allowed to enter into transactions other than on an arm's length basis. Similarly, in a typical high yield indenture, an issuer may not, and may not permit any of its restricted subsidiaries to, enter into or conduct any transaction or series of related transactions (including the purchase, sale, lease or exchange of any property or the rendering of any service) with any affiliate unless such transaction is on arm's length terms. Depending on the value of such transaction, an issuer may be required to get a "fairness opinion" from an independent financial adviser or similar evidencing that the terms are not materially less favourable to the issuer (or to the relevant restricted subsidiary) as would be achieved on an arm's length transaction with a third party.

A receivables subsidiary in connection with a qualified receivables financing will need to engage in multiple affiliate transactions because it will purchase receivables from other members of the group on an ongoing basis and a variety of contractual obligations will arise in connection with such purchases. While the terms of such financing may be structured to qualify as a true sale, and be on arm's length terms, the potential requirement to obtain a "fairness opinion" from an independent financial adviser in connection with each such transaction is an additional burden that the business will want to avoid, and the indenture will therefore need to contain an explicit carve-out from the restriction on affiliate transactions, along the following lines:

*(--) any transaction between or among the Issuer and any Restricted Subsidiary (or entity that becomes a Restricted Subsidiary as a result of such transaction), or between or among Restricted Subsidiaries or any Receivables Subsidiary, effected as part of a Qualified Receivables Financing.*

A similar carve-out can be included in the restrictive covenant relating to arm's length transactions in a loan facility agreement, or in the definition of "Permitted Transaction", where applicable.

Consideration may also need to be given to whether receivables that may be sold in connection with a qualified receivables financing should be carved out from the collateral package on the signing date of the loan facility agreement or high yield indenture.

**Financial covenants**

In addition to the carve-outs described above, the parties will also need to consider carefully whether the activities of the borrower and its subsidiaries in connection with Qualified Receivables Financings may impact the testing of financial covenants in a leveraged facility agreement. Although high yield indentures will typically not contain maintenance covenants, the testing of financial ratios is still important for the purposes of determining whether a particular action may be taken by an issuer or a restricted subsidiary under the high yield indenture at a particular time, or indeed to determine whether a subsidiary must be designated as a "restricted subsidiary" in the first place.

In a high yield indenture, important carve-outs can be accomplished by excluding the effects of the securitisation financing from two key definitions (to the extent not already excluded):

*"Consolidated EBITDA" for any period means, without duplication, the Consolidated Net Income for such period, plus the following to the extent deducted in calculating such Consolidated Net Income (1) Consolidated Interest Expense and Receivables Fees; (-) . . .*

*"Consolidated Interest Expense" means, for any period (in each case, determined on the basis of UK GAAP), the consolidated net interest income/expense of the Issuer and its Restricted*

*Subsidiaries, whether paid or accrued, plus or including (without duplication) . . . Notwithstanding any of the foregoing, Consolidated Interest Expense shall not include (i) . . . (-) any commissions, discounts, yield and other fees and charges related to a Qualified Receivables Financing.*

The treatment of financial covenant definitions in a leveraged facility agreement is complex, and care should be taken to ensure that the treatment of receivables securitisations in the various related definitions is consistent with the base case model used to set the financial covenant levels and with the applicable accounting treatments. Examples of definitions which should take into account receivables securitisations include, the definitions of "Borrowings", "Finance Charges" and "Debt Service".

**Key Issues*****Should an early amortisation of the securitisation facility constitute a cross-acceleration or cross-default to the leveraged finance facility or high yield bonds?***

Leveraged finance facility agreements typically contain a clause providing that the loans can be declared to be repayable immediately should an event of default occur with respect to some third party debt or should such third party debt become payable before its scheduled maturity. High yield bond indentures contain a similar provision, but only triggered upon a payment default under or acceleration of the third party debt, the principal amount of which exceeds a specified threshold. A receivables securitisation financing can be structured so that there is no debt, and therefore no events of default or acceleration can occur. Instead, receivables financings enter into so-called early amortisation pursuant to which the receivables collections that would normally have been paid to the borrower's group to acquire new receivables is paid instead to the provider of the receivables financing.

The commercial risk to lenders and bondholders should an early amortisation event occur is that the cut-off of funds could cause a sudden and severe liquidity crisis at the borrower's group. Thus, subject to a materiality threshold below which the parties agree that the sudden loss of liquidity is not material, cross-default and cross-acceleration triggers in leveraged finance facilities should be tripped if an early amortisation event occurs under a receivables financing facility. A borrower or issuer may also be permitted to avoid a cross-default or cross-acceleration if it delivers a certificate from its Chief Financial Officer within a prescribed time period confirming that the group will have sufficient liquidity to meet its financing requirements during a given period (e.g. 18 months) following the relevant early amortisation event.

The borrower or issuer may wish to exclude early amortisation events relating to certain events outside of its control, such as:

- the inability of any financial institution or asset-back commercial paper conduit to issue commercial paper or draw liquidity;
- the outstanding amount of securitised receivables falling below the threshold set out under the terms of the relevant securitisation; and/or
- breach by the receivables purchaser of any representations, warranties or covenants applicable to it.

In a standard high yield bond indenture, an early amortisation event may or may not trigger an "Event of Default" unless and until such early amortisation event results in a missed bond interest coupon payment or required payment of principal. This is because the missed payment and resulting "acceleration" of the securitisation facility is likely to be structured to occur at a Receivables



Subsidiary that sits outside of the restricted group. This result also comports with the long standing acceptance by high yield bond investors to permit receivables factoring, where a termination of an existing factoring arrangement would also not, in and of itself, result in an “Event of Default” under a standard high yield bond indenture. However, if an issuer’s primary source of liquidity is an existing securitisation arrangement, then counsel and the initial purchasers may wish to consider expanding the standard cross-payment / cross-acceleration “Event of Default” language to also cover an early amortisation event under the existing securitisation financing or any replacement financing.

***How might the non-renewal of the securitisation programme affect the leveraged loans and the high yield bonds?***

For historical reasons, most securitisation facilities must be renewed every year by the receivables funding providers. The leveraged loans and high yield bonds, on the other hand, have far longer maturities. The non-renewal of a securitisation facility prior to the maturity of the leveraged loans and high yield bonds can cause a liquidity crisis at the borrower’s group in the same manner as any early amortisation event, and should be picked up in the leveraged finance and high yield documentation in a comparable manner.

***Should there be any limits to the size of the securitisation facility? If so, how should those limits be defined?***

By its nature, a securitisation financing removes the most liquid assets of a borrower group – the short term cash payments owing to the group from its customers – from the reach of the leveraged lenders and high yield bondholders. Moreover, the amount of new receivables financing raised will never equal the full face value of the receivables sold, because the receivables financing providers will advance funds on the basis of some “advance rate” or subject to certain “reserves” which result in the new funding equalling 75 per cent to 80 per cent of the full face value of the receivables at best. On the other hand, a receivables financing delivers to the borrower group, the lenders and bondholders alike the benefits of lower-cost funding and liquidity. Where the balance between these two competing factors should be struck is for negotiation among the parties, but some balance in the form of a limit to the overall size of the receivables facility seems appropriate.

Should a limit be agreed, the residual question is how that limit should be defined. There are two main options. The limit can be defined by reference to the total outstanding value at any point in time of receivables sold, or it can be defined by reference to the total receivables financing raised. The disadvantage of the latter approach is that it rewards receivables financings with poor advance rates. If a receivables financing has an advance rate of 80 per cent, £500 million face value of receivables is needed to raise £400 million of financing. On the other hand, if a receivables financing has an advance rate of only 50 per cent, £800 million face value of receivables is needed to raise the same £400 million of financing. In the latter example, the leverage lenders and high yield bondholders lose more receivables for little or no additional cost or liquidity benefit.

***Should “ineligible” receivables be sold?***

This issue functions commercially in much the same manner as the advance rate issue discussed immediately above. As summarised at the beginning of this chapter, receivables funding providers only advance funds against receivables that satisfy certain specified eligibility standards. That requirement, however, does not mean that the “ineligible” receivables are any less likely to be paid or that they have actual payment rates that are any less sound compared with eligible receivables. However, the advance rate against an ineligible receivable is 0 per cent and, as a result, including them in the pool of sold receivables will reduce the effective overall advance rate against the pool, with the adverse impact for lenders and bondholders described above. Accordingly, if ineligible receivables constitute any meaningful percentage of a group’s total receivables, it makes sense to require that ineligible receivables be excluded from the receivables financing.

***Should proceeds raised under the securitisation facility be used to repay debt?***

The required and permitted use of proceeds of a securitisation financing is always a key point of negotiation. The outcome of those negotiations will depend upon many diverse factors, including whether the group’s liquidity needs are met by one of the leveraged loan facilities and whether the borrower’s group can bear the higher overall debt burden should no debt repayment be required.

***Should the lenders / bondholders regulate the specific terms of the securitisation?***

Sponsors prefer that the receivables financing carve-outs permit any programme which a responsible officer of the borrower determines in good faith is “on market terms” which is “in the aggregate economically fair and reasonable” to the borrower / issuer and the group. This approach is, in general, the correct one. As indicated above, however, certain issues are sufficiently important for the parties to agree upon in advance. Beyond these and possibly a handful of additional issues, neither lenders nor bondholders should have the right specifically to approve the documentation of the receivables financing facility.

## Conclusion

In summary, with very little modification to the standard leveraged loan or high yield documentation, a trade receivables securitisation financing can easily be added as part of a leveraged buy-out financing or refinancing, thereby providing financing directly to the relevant corporate group on comparatively favourable terms.

**James Burnett**

Latham & Watkins LLP  
99 Bishopsgate  
London EC2M 3XF  
United Kingdom

*Tel:* +44 20 7710 1810  
*Fax:* +44 20 7374 4460  
*Email:* [James.Burnett@lw.com](mailto:James.Burnett@lw.com)  
*URL:* [www.lw.com](http://www.lw.com)

James Burnett is a partner in the London office of Latham & Watkins and is a member of the firm's Corporate Department. His practice includes representing investment banking firms, private equity firms, and companies in public and private debt and equity offerings, bridge loans, acquisition financing and liability management transactions, with a particular emphasis on issuances of high yield debt securities and leveraged transactions.

**Mo Nurmohamed**

Latham & Watkins LLP  
99 Bishopsgate  
London EC2M 3XF  
United Kingdom

*Tel:* +44 20 7710 1839  
*Fax:* +44 20 7374 4460  
*Email:* [Mohamed.Nurmohamed@lw.com](mailto:Mohamed.Nurmohamed@lw.com)  
*URL:* [www.lw.com](http://www.lw.com)

Mo Nurmohamed is a partner in the London office of Latham & Watkins and is a member of the Banking practice group. He has experience across a broad range of issues in banking law, with particular emphasis on matters relating to leverage finance and private equity finance transactions. Mo has particular experience in relation to cross-border acquisition financing transactions and acts for financial institutions, private equity sponsors and major corporations.

**LATHAM & WATKINS<sup>LLP</sup>**

Latham & Watkins is a global law firm with approximately 2,100 lawyers in its offices located in Asia, Europe, the Middle East and the United States, including: Abu Dhabi, Barcelona, Beijing, Boston, Brussels, Chicago, Doha, Dubai, Düsseldorf, Frankfurt, Hamburg, Hong Kong, Houston, London, Los Angeles, Madrid, Milan, Moscow, Munich, New Jersey, New York, Orange County, Paris, Riyadh, Rome, San Diego, San Francisco, Shanghai, Silicon Valley, Singapore, Tokyo and Washington, D.C. For more information on Latham & Watkins, please visit the website at [www.lw.com](http://www.lw.com).

# CLO 3.0: The Impact of Regulations

Craig Stein



Paul N. Watterson, Jr.



Schulte Roth & Zabel LLP

As 2011 began, the collateralised loan obligation (“CLO”) market was poised to make a comeback. In a chapter in this publication titled “On the CLO Horizon — Regulations Expected to Impact CLOs”, we discussed how new regulations might affect the growth of this market. And 2011 did in fact see a modest revival of CLOs, with new issuance for the year totaling approximately \$12 billion. At the start of 2012, in a chapter in this publication titled “New Structural Features for Collateralised Loan Obligations”, we discussed the structural changes made to the governing documents for a post-financial crisis CLO, which has become known as “CLO 2.0”. Those changes helped foster the growth in the CLO market in 2012, when new issuance reached approximately \$55 billion, and in 2013, when CLO issuance exceeded \$81 billion. As we begin 2014, the CLO market is poised to enter a new phase — CLO 3.0 — in which some of the regulations we discussed in 2011 have been finalised and others, while not finalised, are gaining more clarity.

## The Volcker Rule

### Adoption of the Final Rule

Section 619 of the Dodd-Frank Act (commonly referred to as the “Volcker Rule”)<sup>1</sup> prohibits a “banking entity”<sup>2</sup> from acquiring or retaining an ownership interest in, or sponsoring, any hedge fund or private equity fund. The terms “hedge fund” and “private equity fund” include any issuer that does not register with the U.S. Securities and Exchange Commission (the “SEC”) as an investment company under the U.S. Investment Company Act of 1940 (the “Investment Company Act”) based on the exceptions in Section 3(c)(1) or Section 3(c)(7) thereof, and any “similar fund”. Most CLOs have been structured as “3(c)(7)” vehicles, which limit investors (or, in the case of CLOs domiciled outside of the United States, U.S. investors) to “qualified purchasers” (as defined in Section 2(51)(A) of the Investment Company Act). Therefore, managed or “arbitrage” CLOs could fall under the purview of the Volcker Rule, despite the fact that CLOs are not viewed by market participants as hedge funds or private equity funds.

On 10 December 2013, five U.S. federal regulatory agencies (the SEC, CFTC, Federal Reserve, FDIC and OCC) adopted regulations implementing the Volcker Rule (the “Final Rule”).<sup>3</sup> The Final Rule goes into effect on 21 July 2015. The Final Rule provides for an exemption from the Volcker Rule for CLOs that qualify as “loan securitisations” by investing only in loans and not holding any securities other than short-term cash equivalents.

The Final Rule completely carved-out loan securitisations from the definition of a “covered fund”, meaning that the Volcker Rule does

not restrict banking entities from investing in, or entering into transactions with, CLOs which qualify as loan securitisations. It defined a loan securitisation as an asset-backed security (“ABS”) whose assets are comprised solely of loans, “servicing” assets, and interest or foreign exchange derivatives that directly relate to the underlying loans. It specifically excludes as an “impermissible asset” any security, including an ABS (other than cash equivalents and securities received *in lieu* of debts previously contracted with respect to the loans) and any derivative (other than an interest rate or foreign exchange derivative that directly relates to the underlying loans). Thus, a CLO which does not have any securities or structured products in its portfolio is completely exempt from the Volcker Rule. As a result, banking entities are free to provide warehousing facilities to these CLOs and invest in the notes and equity issued by these CLOs, because they are not covered funds subject to the Volcker Rule.

Under the Volcker Rule, with limited exceptions, banking entities are not permitted to hold “ownership interests” in covered funds. The definition of “ownership interest” includes any equity security or partnership interest, but surprisingly also includes a debt security that contains certain “indicia of ownership”. Among those indicia of ownership is the right to participate in the removal or replacement of the investment manager of the covered fund. Since most CLO debt tranches do give the noteholders those rights, they appear to fall within the definition of an ownership interest. The Final Rule recognises that, if the right to exercise replacement or removal rights arises out of an event of default or similar acceleration event, the security is not considered an ownership interest. However, the removal/replacement rights in most CLO management agreements are triggered not only by an event of default but also by certain actions taken by the manager and other events (“for cause” events) that fall short of an event of default. As a result, most CLO notes do qualify as ownership interests and thus banking entities may not hold them unless the issuing CLO qualifies for the loan securitisation exemption.

### Effects on the CLO Market

Although loan securitisations will be exempt from all of the consequences of the Volcker Rule, most CLOs are permitted to invest in high yield bonds and other securities. A February 2014 study by Standard & Poor’s concluded that, as of 31 December 2013, over 80 per cent of the CLOs for which data was available had invested in non-loan assets.<sup>4</sup>

CLOs which cannot qualify as loan securitisations nonetheless may avoid the Volcker Rule entirely by relying on another exemption from the Investment Company Act, such as Rule 3a-7. However,

Rule 3a-7 imposes restrictions on the manager's discretion to sell assets and to reinvest and is best suited for static or lightly managed CLOs. For example, static balance sheet CLOs often rely on this exemption. An issuer relying on Rule 3a-7 cannot acquire or dispose of assets "for the primary purpose of recognizing gains or decreasing losses resulting from market value changes".

Alternatively, a traditional "open market" CLO which does rely on Section 3(c)(7) may qualify as a "loan securitisation" by eliminating its ability to purchase high yield bonds and other debt securities that do not meet the definition of a "loan". Indentures for some recent CLOs prohibit investment in a letter of credit transaction based on the concern that it may not be a loan. The indentures for recent CLO 3.0s prohibit the issuer from acquiring any bonds unless the issuer has been advised by counsel either that the rated notes are not "ownership interests", or that the issuer can rely on Rule 3a-7, or that the acquisition of bonds would not cause the issuer to be a "covered fund". In addition, the authorisations of the CLO to make temporary investments in "cash equivalents" and to enter into hedges in CLO indentures have been revised to ensure that the CLO fits within the loan securitisation exemption to the Volcker Rule.

U.S. Congressmen, banks and industry associations have criticised the regulatory agencies for implementing the Volcker Rule in this way, which restricts bank investment in CLOs that are not loan securitisations. As a result, the regulatory agencies are widely expected to revise the Final Rule so that it does not affect bank ownership of CLO notes — at least CLO notes that were issued prior to 2014.

### Risk Retention

For many investors domiciled in the European Community, risk retention requirements for managers of CLOs are already in effect. On 31 December 2010, the European Banking Authority ("EBA") published its guidelines on the implementation of Article 122a of European Union Directive 2006/48/EC (as amended by Directive 2009/111/EC, "Article 122a"), commonly referred to as the Capital Requirements Directive ("CRD"), and in September 2011 published some additional guidance in the form of a question and answer document (collectively, the "Article 122a Guidelines"). Article 122a applies to credit institutions (and, from 1 January 2014, investment firms) established in a Member State of the EEA and consolidated group affiliates thereof (each, an "Affected 122a Investor") that invest in, or have an exposure to, credit risk in securitisations (including CLOs). Article 122a imposes a severe capital charge on a securitisation position acquired by an EEA-regulated credit institution unless, among other conditions, the originator, sponsor or original lender for the securitisation has explicitly disclosed that it will retain, on an ongoing basis, a material net economic interest of not less than 5 per cent of specified credit risk tranches or asset exposures.

In April 2013, the European Parliament adopted a new directive and a regulation, collectively referred to as "CRD4", which took effect on 1 January 2014. CRD4 replaces and, in certain respects, differs from the requirements in Article 122a, and extends the requirements described above to investment firms as well as credit institutions. In addition, in May 2013, the EBA published a consultation paper on draft regulatory technical standards and implementing technical standards which will replace the current Article 122a Guidelines (the "Draft Technical Standards"). There are significant differences between the Draft Technical Standards and the current Article 122a Guidelines, and there remains uncertainty as to the content of the final regulatory and implementing technical standards and how these will affect CLOs issued prior to their adoption.

Most U.S. CLOs have elected not to comply with the Article 122a Guidelines and have been restricted from marketing to Affected 122a Investors. However, in the future, risk retention requirements will become applicable to most CLOs. The Dodd-Frank Act amended the U.S. Securities Exchange Act of 1934 (the "Exchange Act") to add new Section 15G, which directs the SEC and U.S. federal banking agencies (the "Agencies") jointly to adopt regulations requiring a securitiser to retain an unhedged economic interest in at least 5 per cent of the credit risk of assets that the securitiser, through the issuance of an ABS, transfers to a third party. A securitiser is the issuer of the ABS or an entity that organised and initiated the ABS transaction by transferring assets, directly or indirectly, to the issuer. Section 15G also directed the Agencies to allocate risk retention obligations between a securitiser and an originator in the case of a securitiser that purchases assets from an originator. An originator is the person which, through the extension of credit or otherwise, creates a financial asset that collateralises an ABS and sells an asset directly or indirectly to a securitiser.

In March 2011, the Agencies jointly proposed rules (the "Original CRR Proposal")<sup>5</sup> to implement this credit risk retention requirement. Few (if any) CLOs have followed the "originate to distribute" model used by subprime mortgage securitisers with unfortunate results and, accordingly, there was reason to hope that the Agencies would not impose any risk retention requirement on the typical "open market" CLO. However, the Original CRR Proposal provided that a "sponsor" is the "securitiser" which must satisfy the risk retention requirement,<sup>6</sup> and identified the collateral manager as the sponsor of a CLO and, accordingly, as the entity which must satisfy the risk retention requirement, because "the CLO manager generally acts as the sponsor by selecting the commercial loans to be purchased by an agent bank for inclusion in the CLO collateral pool, and then manages the securitised assets once deposited in the CLO structure".<sup>7</sup>

The Original CRR Proposal included various options for satisfying the credit risk retention requirement: (i) vertical risk retention, which a sponsor may satisfy by retaining at least 5 per cent of each class of ABS interests issued as part of the securitisation transaction; (ii) horizontal risk retention, which the sponsor may satisfy by retaining an eligible residual interest (i.e., a first loss position, which in a CLO is usually in the form of unrated subordinated notes) equal to at least 5 per cent of all ABS interests issued or, alternatively, by funding a cash reserve account in the same amount to bear the first loss; and (iii) L-shaped risk retention, which the sponsor may satisfy by retaining a combination of vertical and horizontal exposures to the credit risk of the securitised assets.<sup>8</sup>

The Original CRR Proposal permitted a sponsor that used the vertical or horizontal risk retention options (but not the L-shaped option) to allocate a portion of its risk retention obligations to any originator that contributed at least 20 per cent of the assets in the securitisation. The Agencies concluded that only the original creditor under a loan could be the originator for these purposes.

In August 2013, the Agencies published a revised proposed credit risk retention rule (the "Revised CRR Proposal") which provided that CLOs must satisfy one of three alternative requirements: (i) the standard risk retention requirement; (ii) the qualifying commercial loan option; or (iii) the CLO-eligible loan option.<sup>9</sup> First, under the Revised CRR Proposal, the vertical, horizontal and L-shaped risk retention options were combined into a single, more flexible requirement. Under this new "standard" risk retention requirement, the sponsor would be permitted to hold an eligible vertical interest, an eligible horizontal interest, or any combination thereof, equal to at least 5 per cent of the fair value of all ABS interests issued as part

of the securitisation transaction. The Revised CRR Proposal preserved the ability to allocate a proportionate amount of the retained risk to an originator that originated at least 20 per cent of the asset pool, and the option is now available when the sponsor retains a combination of vertical and horizontal interests. However, the Agencies also proposed a new restriction on the standard risk retention option, limiting the amount of cash payable to a manager that retains the risk in the form of a horizontal equity interest. Under this restriction, the manager could not receive distributions from the CLO on these retained subordinated notes at a faster rate than the rate at which principal is paid to investors in the senior notes issued by the CLO. As in the Original CRR Proposal, the manager of the CLO was: (i) prohibited from transferring any of the retained credit risk except to an affiliate whose financial statements are consolidated with it; and (ii) prohibited from purchasing or selling a financial instrument, or entering into an agreement, derivative or other position that hedges the retained credit risk. Although the manager or its affiliate could pledge as collateral for a loan any interest that it is required to retain, it could not be a nonrecourse loan in which the lender did not have full recourse to the manager or its affiliate.

Under a second alternative, a CLO could qualify for a zero risk retention requirement if it invested exclusively in commercial loans that satisfy strict underwriting standards (“qualifying commercial loans” or “QCLs”). The underwriting standards proposed by the Agencies require the originator to have determined, among other things, that during the two most recently completed fiscal years and the two-year period after the closing of the commercial loan, the borrower had, or is expected to have: (i) a total liabilities ratio of 50 per cent or less; (ii) a leverage ratio of 3.0 or less; and (iii) a debt service coverage ratio of 1.5 or greater. In addition, the loan documents for each commercial loan acquired by the CLO must satisfy minimum standards, including standards for repayment terms, maturity, security interests (if the loans are secured), and affirmative and negative covenants. The “depositor”<sup>10</sup> of the assets is required to make certifications regarding its process for ensuring that the securitised commercial loans satisfy the applicable requirements, which the sponsor is required to deliver to investors (and to the applicable Agencies upon demand). If a sponsor learns, after the closing of the securitisation transaction, that a loan does not satisfy the underwriting requirements, the sponsor will not lose the exemption if: (i) it repurchases the loan; (ii) it promptly provides notice of the repurchase to the investors; and (iii) the depositor has complied with the initial certification requirement. Finally, only a CLO that has no reinvestment period can utilise the QCL option.<sup>11</sup>

Third, to address the concern that many CLO managers do not have sufficient capital to purchase and hold a 5 per cent interest in their CLOs, the Revised CRR Proposal contains a new alternative risk retention exemption for “open market” CLOs, under which managers would be exempt from the risk retention requirement if the CLO limits its portfolio to “CLO-eligible” loans. CLO-eligible loans are loans in which the lead arranger holds 5 per cent of the face amount of the tranche of the loan purchased by the CLO until the maturity, payment in full, acceleration or payment or bankruptcy default of the loan. The lead arranger must have originated at least 20 per cent of the face amount of the credit facility, with no other member of the syndicate having a larger allocation or commitment. Moreover, the loan documents must give holders of a CLO-eligible tranche consent rights with respect to, among other things, material waivers and amendments of the loan documents. To take advantage of this alternative, the CLO must: (i) acquire only CLO-eligible loans and servicing assets; (ii) not purchase any ABS or synthetic securities (e.g., credit default

swaps); (iii) purchase all assets in the open market; and (iv) provide a complete list of every asset held in the CLO (prior to CLO issuance, upon request from the Agencies and on an annual basis).

### CLO Industry Response

Most of the asset management firms which act as the collateral managers for CLOs do not have adequate capital to purchase and hold 5 per cent of the notional amount of a CLO. For example, the manager of a \$500 million CLO would have to purchase \$25 million of notes. Larger managers that have access to adequate capital are unwilling to make capital commitments of this magnitude for the life of a CLO as part of their business plan, and complain that managers of mutual funds, business development companies and hedge funds, which also invest in the commercial loan market, are not subject to any similar requirement. Additionally, the restriction on the standard manager risk retention that prohibits the manager from receiving payments at a faster rate than the amortisation of the senior notes is inconsistent with the way in which CLOs are structured. The holders of the subordinated notes of a CLO receive distributions during the reinvestment period of a CLO, whereas the senior tranches typically receive no principal payments until after the reinvestment period. The zero risk retention option for a portfolio comprised solely of qualifying commercial loans is also unavailable in practice, because the underwriting standards proposed by the Agencies do not comport with the broadly syndicated loan market and most arbitrage CLOs do include a reinvestment period.

CLO Managers and the banks that originate loans have criticised the third alternative, “CLO-eligible loans”, for open market CLOs, arguing that the lead arranger of a loan will not agree to hold a large portion of a loan without the ability to hedge or sell it for the life of the loan. This would be contrary to a bank’s risk management policies (and to the policies of some of the Agencies that proposed the rule).

### Effects on the CLO Market

If the Revised CRR Proposal is approved as the final rule, we could see significant consolidation of the managers in the CLO market because only larger, well capitalised managers will have the ability to purchase and hold indefinitely 5 per cent of the notional amount of the notes issued by each CLO which they manage. This, in turn, could result in a decline in the volume of new CLOs coming to market.

There is also significant uncertainty regarding how the requirements of the Revised CRR Proposal would be implemented. CLOs which have complied with Article 122a have required the originator, the manager or its consolidated affiliate to enter into a risk retention agreement in order to impose contractual obligations which embody the risk retention requirement. Counsel to future CLOs will need to translate the broad conceptual requirements of the Revised CRR Proposal (if it becomes the final rule) into the terms of this agreement. For example, if the manager is removed or resigns, would a successor manager be required to purchase the 5 per cent risk retention of the removed or resigned manager? If so, this requirement makes it more difficult to find a successor manager. If the restrictions on distributions to the manager on the retained subordinated notes described above remain, will managers purchase a vertical interest instead? If a manager does purchase an eligible horizontal residual interest, the CLO may need to structure the manager’s subordinated notes so that they have different payment terms than the subordinated notes sold to third parties.

And what happens to the excess interest that would otherwise be distributed to the manager? Will it be held in a separate reserve account only to be used under certain circumstances or will it be reinvested in additional assets?

Many industry associations have pointed out to the Agencies the adverse effects that the Revised CRR Proposal would have on the CLO market, and have proposed modifications to each of the three alternative options for CLOs to satisfy or escape the risk retention requirement. These proposals have ranged from modifications to the requirements for a commercial loan to qualify as a QCL or as a CLO-eligible loan to additional alternatives under which investors other than the collateral manager would retain the required risk. Several of the proposals have suggested that, for CLOs which satisfy strict requirements, the amount of risk required to be retained by the manager should be lower. The Loan Syndications and Trading Association (“LSTA”) proposed that if a CLO meets the requirements for a “Qualified CLO”, the manager would only be required to purchase and retain 5 per cent of the equity tranche (not 5 per cent of the notional amount of the CLO). For example, the manager of a \$500 million CLO with a \$50 million unrated subordinated note or equity tranche (which would be required to purchase \$25 million of notes under the Revised CRR Proposal) would be required to purchase \$2.5 million of the subordinated notes or equity tranche under the LSTA proposal. In order for a CLO to become a Qualified CLO to which this reduced risk retention would be applicable, the CLO must satisfy a detailed list of “industry best practices” including: (i) asset quality; (ii) portfolio concentration limitations; (iii) structural features; (iv) alignment of the interests of the manager and other investors in the CLO; (v) transparency and disclosure to investors; and (vi) regulatory oversight of the manager.

The Agencies will adopt the final regulations in the near future, and they will become effective two years after the date on which they are published in the Federal Register.

## Foreign Account Tax Compliance Act

### In General

On 17 January 2013, the U.S. Treasury issued final regulations implementing Sections 1471 through 1474 of the U.S. Internal Revenue Code of 1986 (commonly referred to as “FATCA”). FATCA generally requires “foreign financial institutions” (“FFIs”) (including CLOs) to enter into information sharing agreements with the U.S. Internal Revenue Service (the “IRS”) and to report certain information about their U.S. accounts to the IRS on an annual basis in order to avoid 30 per cent withholding on certain U.S.-connected payments (including U.S. source interests and gross sale proceeds from the disposition of U.S. debt obligations).

The final regulations provide that FATCA withholding generally will not apply to any U.S. debt obligations outstanding on 1 July 2014, unless such obligations are materially modified after that date.

The final regulations provide for the concept of withholding on a “foreign passthrough payment”, which will begin no earlier than 1 January 2017, in respect of “recalcitrant account holders” (generally, an account holder that fails to comply with requests for information under FATCA) or “non-compliant FFIs” (generally, an FFI that does not enter into an information sharing agreement with the IRS, comply with laws implementing an applicable IGA (as defined below), or otherwise benefit from an exception to these requirements). Preliminary guidance that was not included in the final regulations suggested that a payment with respect to a CLO

note will be treated as a foreign passthrough payment to the extent of (i) the amount (if any) of the payment that is treated as U.S. source income, plus (ii) the amount of the payment that is not treated as U.S. source income multiplied by a ratio equal to the CLO’s average U.S. assets to its average total assets, determined as of specified testing dates. It remains to be seen what approach to foreign passthrough payments will be adopted under FATCA.

### IGAs

The U.S. Treasury has developed an alternative approach for FFIs resident in a country that has entered into an intergovernmental agreement (“IGA”) with the U.S. The U.S. Treasury has entered into an intergovernmental agreement with the Cayman Islands (the “Cayman IGA”) that, among other things, provides for direct information sharing between the Cayman Islands and the United States and modifies the requirements for foreign financial institutions located in the Cayman Islands that qualify for the Cayman IGA.

As a result, CLOs organised under the laws of the Cayman Islands will not be required to execute an individual FFI agreement with the U.S. Treasury. The Cayman Islands has not yet promulgated the legislation, rules and regulations to give effect to the term of the Cayman IGA.

### Revisions to CLO Indentures

The transaction documents for post-FATCA CLOs generally contain provisions to address FATCA, such as the following:

- providing that a holder of CLO securities agrees or is deemed to agree to (i) provide any information and documentation and to take any other action necessary for the CLO to achieve FATCA compliance and avoid or reduce FATCA withholding taxes, and (ii) allow the CLO to provide any such information or documentation and any other information concerning the holder’s investment in CLO securities to the IRS or other relevant tax authority (“Noteholder Reporting Obligations”);
- providing for the ability of the CLO and its trustee to compel a holder of CLO securities which fails to meet its Noteholder Reporting Obligations to sell its CLO securities or to sell such securities on such noteholder’s behalf;
- providing that the indenture may be amended without noteholder consent to the extent necessary or advisable for the CLO to achieve FATCA compliance; and
- separating out FATCA compliance costs and FATCA withholding tax from the general tax event redemption trigger and providing separate tax event triggers for FATCA-related costs.

### Limited Life Debt Investment Entities

On 20 February 2014, the U.S. Treasury released the “last substantial package of regulations necessary to implement FATCA”, which significantly modified the definition of “limited life debt investment entity” (“LLDIE”) in the 17 January 2013, final regulations. Under the newly issued regulations, an FFI which meets the following requirements would be considered a “certified deemed compliant entity” (and, as a result, not have FATCA compliance obligations) if:

- the FFI is an investment entity that issued one or more classes of debt or equity interests to investors pursuant to a trust indenture or similar agreement and all of such interests were issued on or before 17 January 2013;

- the FFI was in existence as of 17 January 2013, and has entered into a trust indenture or similar agreement that requires the FFI to pay to investors holding substantially all of the interests in the FFI, no later than a set date or period following the maturity of the last asset held by the FFI, all amounts that such investors are entitled to receive from the FFI;
- the FFI was formed and operated for the purpose of purchasing or acquiring specific types of debt instruments or interests therein and holding those assets subject to reinvestment only under prescribed circumstances to maturity;
- substantially all of the assets of the FFI consist of debt instruments or interests therein;
- all payments made to the investors of the FFI (other than holders of a *de minimis* interest) are either cleared through a clearing organisation or custodial institution that is a participating FFI, reporting Model 1 FFI, or U.S. financial institution or made through a transfer agent that is a participating FFI, reporting Model 1 FFI, or U.S. financial institution; and
- the FFI's trustee or fiduciary is not authorised through a fiduciary duty or otherwise to fulfil the obligations of a participating FFI and no other person has the authority to fulfil the obligations of a participating FFI on behalf of the FFI.

It is anticipated that Cayman Islands legislation implementing the Cayman IGA will have a corresponding exemption from Cayman Islands compliance obligations. Pre-FATCA CLOs (i.e., pre-2010 CLOs) whose indentures do not contemplate FATCA are the CLOs that may be eligible to be treated as LLDIEs. Language added to the indenture for a 2011 or 2012 CLO to address FATCA compliance (and described above) could prevent such CLO from satisfying the LLDIE requirements if it is determined that the CLO's trustee, other fiduciary or other person is authorised to fulfil the compliance obligations under FATCA or an applicable IGA.

\* \* \*

The CLO market is adapting to the new regulatory requirements which have been imposed as a result of the credit crisis by adopting a new transaction structure — CLO 3.0. The CLO market fared relatively well under FATCA and the Volcker Rule compared to the more onerous treatment of CLOs in the earlier proposals implementing those laws. Risk retention, on the other hand, could have a significant adverse impact on the CLO market if it is implemented in its current proposed form.

## Endnotes

- 1 Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. § 619 (2010).

- 2 The term “banking entity” means any insured depository institution, any company that controls an insured depository institution, or that is treated as a bank holding company under Section 8 of the International Banking Act of 1978, and any affiliate or subsidiary of any such entity.
- 3 Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5808 (31 January 2014).
- 4 S&P Capital IQ, “CLO Collateral Pool Review: Non-Loan Assets As Of First-Quarter 2014”, 6 February 2014.
- 5 Credit Risk Retention, 76 Fed. Reg. 24090 (29 April 2011).
- 6 The proposed definition of the term “sponsor” in the Original CRR Proposal is a person who organises and initiates a securitisation transaction (defined as a transaction involving the offer and sale of ABS by an issuing entity) by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity.
- 7 See footnote number 42 of the Original CRR Proposal.
- 8 The Original CRR Proposal also included a fourth option — representative sample risk retention — which the sponsor may satisfy by retaining a randomly selected sample of assets equivalent to the assets which are securitised in an amount equal to at least 5 per cent of the unpaid principal balance of the pool of assets. However, this option would not have been practical for a CLO, and has since been withdrawn for consideration by the Agencies.
- 9 Credit Risk Retention, 78 Fed. Reg. 57928 (20 September 2013).
- 10 The term “depositor” is defined in the proposed rules as: (1) the person that receives or purchases and transfers or sells the securitised assets to the issuing entity; (2) the sponsor, in the case of a securitisation transaction where there is not an intermediate transfer of the assets from the sponsor to the issuing entity; or (3) the person that receives or purchases and transfers or sells the securitised assets to the issuing entity in the case of a securitisation transaction where the person transferring or selling the securitised assets directly to the issuing entity is itself a trust.
- 11 This was included in clause (a)(2) in the proposed rule for “Underwriting standards for qualifying commercial loans” in the Original CRR Proposal and in clause (a)(3) in the proposed rule for “General exception for qualifying assets” in the Revised CRR Proposal.

## Acknowledgment

The authors would like to acknowledge the assistance, in the preparation of this chapter, of Audrey Wei, an associate in the Tax Group and Jacob B. Wentworth, an associate in the Structured Products & Derivatives Group at Schulte Roth & Zabel LLP.

**Craig Stein**

Schulte Roth & Zabel LLP  
919 Third Avenue  
New York, NY 10022  
USA

Tel: +1 212 756 2390  
Fax: +1 212 593 5955  
Email: [craig.stein@srz.com](mailto:craig.stein@srz.com)  
URL: [www.srz.com](http://www.srz.com)

Craig Stein is a partner and co-head of the Structured Products & Derivatives Group at Schulte Roth & Zabel LLP. His practice focuses on structured finance and asset-backed transactions, swaps and other derivative products, including credit- and fund-linked derivatives, prime brokerage and customer trading agreements. He represents issuers, underwriters, collateral managers and portfolio purchasers in public and private structured financings, including collateralised loan obligations. Mr. Stein has been recognised by leading peer-review publications as a leader in the industry and he speaks and writes widely on advanced financial products. He earned his undergraduate degree, *cum laude*, from Colgate University and his J.D., *cum laude*, from the University of Pennsylvania Law School. He is a member of the Loan Syndications and Trading Association, the International Swaps and Derivatives Association, the Structured Finance Industry Group, the American Bar Association and the New York State Bar Association.

**Paul N. Watterson, Jr.**

Schulte Roth & Zabel LLP  
919 Third Avenue  
New York, NY 10022  
USA

Tel: +1 212 756 2563  
Fax: +1 212 593 5955  
Email: [paul.watterson@srz.com](mailto:paul.watterson@srz.com)  
URL: [www.srz.com](http://www.srz.com)

Paul N. Watterson, Jr. is a partner and co-head of the Structured Products & Derivatives Group at Schulte Roth & Zabel LLP. He concentrates on structured product and derivative transactions, formation and representation of credit funds and capital markets regulation, and is counsel to many participants in the securitisation, credit and derivatives markets. He represents underwriters, issuers and managers in structured financings, including CLOs, and is involved in structured finance transactions that use credit derivatives, including regulatory capital transactions and repackagings. He advises funds and other alternative investment vehicles on their transactions in derivatives, loans, asset-backed securities and CDOs. Mr. Watterson has also been active in the creation of derivative products that reference hedge funds. He is a regular speaker at major industry events and is widely published and recognised by peer-reviewed publications. He earned his A.B., *cum laude*, from Princeton University, and his J.D., *magna cum laude*, from Harvard Law School.

## Schulte Roth & Zabel

Schulte Roth & Zabel LLP ([www.srz.com](http://www.srz.com)) is a full-service law firm with offices in New York, Washington DC and London. We represent investment managers, issuers, investors and placement agents in offerings of a variety of investment products, including private investment funds and structured products. Our firm also structures derivatives products, including unleveraged and leveraged derivatives referencing bonds, loans, investment funds, commodities, equity securities, interest rates and currencies, and advises clients on forwards, repurchase agreements, securities lending agreements, prime brokerage agreements and master netting agreements. The firm's tax, ERISA, investment management, regulatory and bankruptcy lawyers have experience with these products and lend their expertise to every transaction.



# The What, Why and How of “Accounting for Securitisation under IFRS”

William Fellows



Sherif Sakr



Deloitte & Touche LLP

Accounting for securitisations under International Financial Reporting Standards (“IFRS”) is primarily addressed in International Accounting Standard (“IAS”) 39, *Financial Instruments: Recognition and Measurement*. Typically, securitisation transactions are complex, involving multiple parties and specially designed structured entities to facilitate the transactions. The accounting guidance mirrors this complexity and continues to evolve, particularly in light of the recent economic downturn.

As we will explore further below, the question of whether the transfer of the financial assets underlying a securitisation constitutes a “sale” for accounting purposes requires the transferor to go through seven steps. The first step, “*Consolidate all subsidiaries, including any SPEs*” is addressed first and at length below. IFRS 10 – *Consolidated Financial Statements*, is itself a complex standard that requires careful analysis of the transferor’s involvement with the structured entity. To keep our comments brief, we have constrained our discussion of IAS 39 and IFRS 10 to features typically seen in securitisation transactions. We have also attempted to call out similarities and differences between IFRS and United States Generally Accepted Accounting Principles (“U.S. GAAP”) when relevant to the discussion. The diversity of securitisation transactions would make it difficult to cover in detail all the accounting considerations that must be made for a securitisation transaction, but we hope that this overview will provide insights nonetheless.

## Consolidation of Structured Entities

IFRS no longer provides specific guidance for special purpose entities that may be used for securitisation purposes, as it had under Standing Interpretations Committee (“SIC”) Interpretation – 12, *Special Purpose Entities*. IFRS 10, which has been effective for annual periods beginning on, or after, 1 January 2013, provides the consolidation guidance for all entities under IFRS. This is a key distinction between IFRS and U.S. GAAP, as U.S. GAAP provides for specific consolidation rules for (1) variable interest entities, (2) partnerships and similar entities, and (3) voting interest entities.

The investor (which for the purposes of this discussion includes the transferor), regardless of the nature of its involvement, must consolidate an investee entity if it determines that it has control over the investee. Investors have control over investees, if they exhibit the following three elements of control:

- power over the investee – whether the investor has the right to control the relevant activities of the investee. Relevant activities are those activities of the investee that most significantly impact the investee’s returns;

- exposure to variable returns – whether the investor is exposed, or has rights, to variable returns due to its involvement with the investee. These returns can be either positive or negative and will vary as a result of the entity’s performance; and
- the ability to use its power over the investee to affect the amount of the investor’s returns.

IFRS 10 provides further guidance when determining whether the three elements of control exist over the investee:

- the purpose and design of the investee;
- the relevant activities of the investee and how decisions about those activities are made;
- whether the investor’s rights give it the current ability to direct the relevant activities;
- whether the investor is exposed, or has rights, to variable returns from its involvement with the investee; and
- whether the investor has the ability to use its power over the investee to affect the amount of the investor’s returns.

Note that these elements of control are not dependent on voting rights. Various structured entities are created for securitisation purposes that have relevant activities that are controlled by means outside of voting rights. We will address the entities with those characteristics below.

Investors need to make this determination on a continuous basis. As such, investors may consolidate or deconsolidate an entity as circumstances change over time or due to the occurrence of some event subsequent to the initial set-up of the entity. Investors also need to be aware of their relationships with other parties that may be involved with the investee when making a determination of whether the investor controls the investee.

## Power over Structured Entities

“Power” exists when the investor has existing rights that give it the current ability to direct the activities that significantly affect the investee’s returns (the “relevant activities”). Rights to direct the relevant activities do not need to be exercised to provide an investor with power. If two or more investors have rights to direct different relevant activities, the investors must decide which of the relevant activities most significantly affect the returns of the investee.

Many structured entities employed for securitisation purposes are created such that many of its operations are predetermined. Most rights, obligations and other activities are determined by the contractual arrangements governing the entity. However, having predetermined activities is not the same thing as having no “relevant activities”.

Often, the relevant activities of a structured entity used for securitisation are contingent upon some change in circumstances. For example, many securitisation structured entities use asset servicers that engage in primarily administrative functions that do not constitute “relevant activities”. However, in situations where the underlying assets held by the entity enter default or are otherwise under distress, a “special servicer” may take over responsibility for those assets, in an attempt to maximise collection on those distressed assets. The activities of that special servicer and the decisions that it could make would usually be relevant activities for that entity. The right to make those decisions exists, whether or not the event has occurred.

IFRS illustrates these principles in two Examples<sup>1</sup>:

#### **First Example**

An investee’s only business activity, as specified in its founding documents, is to purchase receivables and service them on a day-to-day basis for its investors. The servicing on a day-to-day basis includes the collection and passing on of principal and interest payments as they fall due. Upon default of a receivable, the investee automatically puts the receivable to an investor as agreed separately in a put agreement between the investor and the investee. The only relevant activity is managing the receivables upon default because it is the only activity that can significantly affect the investee’s returns. Managing the receivables before default is not a relevant activity because it does not require substantive decisions to be made that could significantly affect the investee’s returns – the activities before default are predetermined and amount only to collecting cash flows as they fall due and passing them on to investors. Therefore, only the investor’s right to manage the assets upon default should be considered when assessing the overall activities of the investee that significantly affect the investee’s returns. In this example, the design of the investee ensures that the investor has decision-making authority over the activities that significantly affect the returns at the only time that such decision-making authority is required. The terms of the put agreement are integral to the overall transaction and the establishment of the investee. Therefore, the terms of the put agreement together with the founding documents of the investee lead to the conclusion that the investor has power over the investee even though the investor takes ownership of the receivables only upon default and manages the defaulted receivables outside the legal boundaries of the investee.

#### **Second Example**

The only assets of an investee are receivables. When the purpose and design of the investee are considered, it is determined that the only relevant activity is managing the receivables upon default. The party that has the ability to manage the defaulting receivables has power over the investee, irrespective of whether any of the borrowers have defaulted.

### **Structured Entities with No Ongoing Decision Making**

As illustrated above, most structured entities are expected to have some sort of decision making that pertains to relevant activities of the investee, even though that decision making is predetermined by the contractual agreements to some extent. However, an entity could be designed such that there are no decisions made with respect to the relevant activities of the structured entity. A careful assessment must be made when determining whether the investor’s involvement in the design of the entity is sufficient to conclude that the investor has power of the entity’s relevant activities. Many parties are typically involved at that stage and they all must be in

agreement to execute the transaction. Understanding the purpose and design of an investee is the means by which an investor identifies the relevant activities, the rights from which power arises and who holds those rights. It can also assist in identifying investors that may have sought to secure control and whose position should be understood and analysed when assessing control.<sup>2</sup> Thus, it is possible that the control was established during this stage of the structured entity’s existence.

### **Consolidation of “Silos” or “Cells”**

In some situations, an investor may have interests in a portion of the structured entity or in specified assets and/liabilities of that entity. Under IFRS 10, specified assets of the investee must be the only source of payment for the specified liabilities of, or specified other interests in, the investee. Parties other than those with the specified liability do not have rights or obligations related to the specified assets or to residual cash flows from those assets. Thus, all the assets, liabilities and equity of that deemed separate entity are ring-fenced from the overall investee. There is similar guidance under U.S. GAAP for variable interests in the specific assets of a variable interest entity.

The assessment of whether an investor should consolidate the deemed entity (sometimes referred to as a “silo” or “cell”) is the same as for other entities under IFRS 10, but is restricted to the relevant activities that pertain to the specified assets and liabilities of the deemed entity.

### **Disclosures for Involvement with Structured Entities**

IFRS 12, *Disclosures for Interests in Other Entities*, requires specific disclosures for investors with involvement with structured entities. The IASB concluded that the economic downturn highlighted the importance of increasing the transparency of an entity’s relationships with both consolidated and unconsolidated structured entities.

An entity must make disclosure of significant judgments and assumptions made in determining whether it has control, joint control, or significant influence over a structured entity. It should also provide these disclosures when changes in facts and circumstances affect the entity’s conclusion during the reporting period.

IFRS 12 requires disclosures regarding unconsolidated structured entities. Financial Statements’ users must be able to understand the nature and extent of the entity’s interests in the unconsolidated structured entities and the nature of, and changes in, the risks associated with its interests in the unconsolidated structured entity.

These disclosures, which will be both qualitative and quantitative, include the following:

- the nature, purpose, size and activities of the structured entity and how the structured entity is financed;
- the carrying amounts of assets and liabilities related to interests in unconsolidated structured entities and how they compare to the maximum exposure to loss from those interests; and
- any support provided to an unconsolidated structured entity when there is no contractual obligation to do so. This should include support that may have been made for “reputational reasons”.

## Derecognition of Financial Assets

Now that we have answered the consolidation question, which is an important first step in the assessment as it defines at which level the derecognition decision is to be applied (i.e., at the parent's separate financial statements or in the consolidated financial statements), our focus shifts next to whether the transferred financial assets can be derecognised from the financial statements of the transferor.

The evaluation of transfers of financial assets under IFRS focuses on a dual test which is a combination of *risks and rewards* and *control* tests. This presents one of the largest differences compared to U.S. GAAP, where the focus is on whether a transferor has surrendered control over a financial asset without much regard to transfer of risks and rewards.<sup>3</sup> While IAS 39 has sometimes been criticised for its dual test which is a mix of two accounting models that can create confusion and complexity in application, IAS 39 has addressed this criticism by providing a clear hierarchy for application of the two sets of tests: risks and rewards tests are applied first, with the control tests used only when the entity has neither transferred substantially all the risks and rewards of the asset nor retained them. It is also important to note the objectives of this dual test; the risks and rewards tests seek to establish whether, having transferred a financial asset, the entity continues to be exposed to the risks of ownership of that asset and/or continues to enjoy the benefits that it generates, while the control tests are designed with a view to understanding which entity controls the asset (i.e., which entity can direct how the benefits of that asset are realised).

The one additional notable difference compared to U.S. GAAP is the notion of “stickiness” which is inherent in the IAS 39 derecognition model, i.e., it is more difficult to remove an asset from an entity's statement of financial position (balance sheet) than it is to recognise that asset in the first place. Transfer of legal title to a financial asset to another party is not sufficient to derecognise that asset. The substance of the arrangement must be assessed in order to determine whether an entity has transferred the economic exposure associated with the rights inherent in the asset (i.e., its risks and rewards) and, in some cases, control of those rights as further explained below.

### What Are the Steps which Must Be Met to Achieve Derecognition under IFRS?

#### *Step 1 – Consolidate all subsidiaries, including any SPEs.*

Refer to the discussions above regarding consolidation considerations and conditions which must be met.

#### *Step 2 – Determine whether the derecognition principles are applied to part or all of an asset (or group of similar assets).*

Determining what is being evaluated for derecognition is an important early step in the evaluation. The transferred asset could be a whole financial asset, a group of financial assets, part of a financial asset, or part of a group of similar financial assets. The derecognition principles are applied to part of a financial asset (or a group of *similar* financial assets) if the part comprises one of the following:

- specifically identified cash flows (e.g., an interest or principal strip from a debt instrument);
- a fully proportionate share of the cash flows (e.g., the rights to the cash flows on 90 percent of all cash flows arising from a debt instrument); or
- a fully proportionate share of specifically identified cash flows (e.g., 90 percent of the cash flows that arise on the interest strip from a debt instrument).

In all other cases, the financial asset (or the group of financial assets) is considered in its entirety. IAS 39 does not provide any guidance regarding what makes assets “similar”. “Similar” generally means that the two instruments have contractually specified cash flows that are similar in amounts and timings, and have similar risk attributes. An entity should consider the similarity of terms (e.g., prepayment features, interest rates, currency denomination). By definition, there will always be some differences between similar instruments, otherwise they would be identical. Careful consideration is needed when assessing what constitutes “similar” for the purposes of this step.

#### *Step 3 – Have the rights to the cash flows from the asset expired?*

This is perhaps one of the simpler criteria in this assessment. An entity derecognises a financial asset when the rights to the cash flows from that financial asset expire. The rights to the cash flows expire when, for example, a financial asset reaches its maturity and there are no further cash flows arising from that asset, or a purchased option reaches its maturity unexercised. An entity may have a right to receive certain, or all, cash flows from a financial asset over a specified period of time which may be shorter than the contractual maturity of that financial asset. In that case, the entity's right to the cash flows expires once the specified period expires.

#### *Step 4 – Has the entity transferred its rights to receive the cash flows from the asset?*

A transfer may involve transferring the contractual rights to the cash flows of a financial asset, or it may involve retaining the contractual rights to the cash flows, but assuming a contractual obligation to pass on those cash flows to other recipients (i.e., a pass-through arrangement).

When an entity enters into a pass-through arrangement (i.e., the entity agrees to receive cash flows and has a concurrent obligation to pay those cash flows to the eventual recipient), the entity should treat the transaction as a transfer of a financial asset if, and only if, all of the following conditions are met:

- the entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. Said differently, the entity does not benefit or suffer from performance or non-performance of the asset;
- the entity is prohibited by the terms of the transfer arrangement from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows. In other words, the entity does not have control of the future economic benefits associated with the transferred asset; and
- the entity has an obligation to pass on or remit the cash flows that it has collected on behalf of the eventual recipients without material delay, is prohibited from reinvesting the cash flows received in the short settlement period between receiving them and remitting them to the eventual recipient in anything other than cash or cash equivalents and any interest earned on such investments must be passed on to the eventual recipients (i.e., the entity has no access to the benefits of the asset). The term “without material delay” does not mean instantaneously, nor does it imply an extended length of time. The contractual arrangement will need to be considered in full in order to make an assessment as to whether the timeframe between the collection of cash flows on the underlying assets and the point at which they are passed on to the eventual recipients is material in the context of the contractual arrangements of the transfer.

#### *Step 5 – Has the entity transferred substantially all of the risks and rewards of ownership of the asset?*

Determining the extent to which the risks and rewards of the transferred asset have been transferred and retained is critical in

determining the accounting outcome for a transfer. The greater the risks and rewards retained, the greater is the likelihood of continued recognition. The degree to which risks and rewards have been transferred and its effect on the accounting outcome under Steps 5, 6 or 7 can be illustrated as follows:

Substantially all risks/rewards transferred		Derecognise old assets
Transferred and retained risks/rewards are both less than substantially all	Control passed – transferee can unilaterally sell entire asset	Recognise any new assets/liabilities
	Control retained	Recognise assets & liability up to continuing involvement level plus any retained interest
Substantially all risks/rewards retained		Recognise all assets, proceeds are liability

When an entity transfers substantially all of the risks and rewards of ownership of the financial asset, the asset should be derecognised. The entity may have to recognise separately any rights and obligations created or retained in the transfer. IAS 39 provides three examples of transferring substantially all the risks and rewards of ownership:

- 1) an unconditional sale of a financial asset;
- 2) a sale of a financial asset together with an option to repurchase the financial asset at its fair value at the time of repurchase; and
- 3) a sale of a financial asset together with a put or call option that is deeply out of the money (i.e., an option that is so far out of the money that it is highly unlikely to be in the money before expiry).

In the first example, it is clear that there has been a transfer of all the risks and rewards of ownership of the asset. In the second example, the entity has sold the asset and, although it can call the asset back, this can only be done at the fair market value of the asset at the time of reacquisition. The entity is in the same economic position as having sold the asset outright, with the ability to go into the market to reacquire the asset (i.e., it has transferred the full price risk of the asset). In the third example, the option is highly unlikely ever to be exercised and has very little value, which is substantially the same economic position as an unconditional sale.

There is no bright line provided in IAS 39 as to what is meant by a transfer of “substantially all” of the risks and rewards of ownership, and a significant degree of judgment is required when applying the risks and rewards test. There are other references in IAS 39 to various yardsticks that need to be met when applying certain paragraphs. For example, when comparing the old and new terms of a financial liability, the terms are considered to be “substantially different” if the present value of the cash flows under the new terms is at least 10 percent different from the discounted present value of the remaining cash flows of the original financial liability. While IAS 39 does not apply the 90 percent test to derecognition of financial assets, it would seem imprudent to conclude that substantially all the risks and rewards of ownership have been transferred when the computations show that the entity still retains more than 10 percent of the exposure to the variability in present value of the expected future cash flows post-transfer.

IAS 39 acknowledges that in many cases it will be clear whether or not substantially all of the risks and rewards of ownership have been transferred. When it is unclear, then an entity will have to evaluate its exposure before and after the transfer by comparing the

variability in the amounts and timing of the net cash flows of the transferred asset. If the exposure to the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer, then the entity has not transferred substantially all of the risks and rewards of ownership.

*Step 6 – Has the entity retained substantially all of the risks and rewards of ownership of the asset?*

If the entity has retained substantially all of the risks and rewards of ownership of a financial asset, the entity should continue to recognise that financial asset. IAS 39 provides examples of transfers where substantially all of the risks and rewards of ownership have been retained and, therefore, derecognition is not permitted:

- a sale and repurchase transaction where the repurchase price is a fixed price or the sale price plus a lender’s return;
- a securities lending transaction;
- a sale of a financial asset together with a total return swap that transfers the market risk back to the entity;
- a sale of a financial asset together with a deep in-the-money written put option or purchased call option (i.e., an option that is so far in the money that it is highly unlikely to go out of the money before expiry); and
- a sale of short-term receivables in which the entity guarantees to compensate the transferee for credit losses that are likely to occur.

When it is unclear whether the entity has retained substantially all of the risks and rewards of ownership of the asset, it should look at its exposure before and after the transfer by comparing the variability in the amounts and timing of the net cash flows of the transferred asset.

*Step 7 – Has the entity retained control of the asset?*

When an entity determines, based on Steps 5 and 6 above, that it has neither transferred nor retained substantially all of the risks and rewards of ownership of the transferred assets, it needs to make an assessment as to whether or not it has retained control of the asset. If the entity has not retained control of the financial asset, the entity should derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer. If the entity has retained control of the financial asset, the entity should continue to recognise the financial asset to the extent of its *continuing involvement* in the financial asset.

An entity controls a financial asset when it is able to sell that asset. When the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without the imposition of additional restrictions on the transfer, the transferee controls the asset and, therefore, the transferor must have relinquished control. Unilateral and unrestricted ability to sell means that there can be no strings attached to the sale. If the transferee has to attach a call option over the asset when it sells it, or introduce conditions over how the asset is serviced, in order to satisfy the terms of the original transfer, then strings exist and the test of practical ability is not met.

Continuing involvement in a financial asset may come in different forms and typically requires careful consideration. Some common forms of continuing involvement include:

- *Clean-up calls.* The servicer of transferred assets, which may be the transferor, may hold either of two types of options to reclaim previously transferred assets. A removal-of-accounts provision (“ROAP”) is an option to repurchase assets, usually subject to certain limitations on how the particular assets are selected for call, how frequently, and in what total amount the call can be exercised. A clean-up call is an option to purchase remaining transferred assets when

the amount of outstanding assets falls to a specified level at which the cost of servicing those assets becomes burdensome in relation to the benefits of servicing. Provided that such a ROAP or clean-up call results in the transferor neither retaining nor transferring substantially all the risks and rewards of ownership and the transferee cannot sell the assets, it precludes derecognition only to the extent of the amount of the assets that is subject to the call option.

- *Subordinated retained interests and credit guarantees.* The transferor may provide credit enhancement by subordinating some or all of its interest retained in the transferred asset. Alternatively, the transferor may provide a credit guarantee that could be either unlimited or limited. If the transferor retains substantially all the risks and rewards of ownership of the transferred asset, the asset continues to be recognised in its entirety. If the transferor retains some, but not substantially all, of the risks and rewards of ownership and has retained control, the transferor continues to recognise the assets to the extent of the amount of cash or other assets that the transferor could be required to pay.

In closing, there are many considerations which go into arriving to an accounting conclusion for a transfer of financial assets into a securitisation structure. Careful evaluation of all facts and circumstances and full understanding of the substance of the transaction, including, risks and rewards and controls aspects are critical considerations that will directly impact the outcome of the analysis and how the securitisation transaction is presented on the financial statements.

### Endnotes

- 1 IFRS 10 – Appendix B; Examples 11 and 12.
- 2 IFRS 10; paragraph BC 79.
- 3 ASC 860, *Transfers and Servicing*.



#### William Fellows

Deloitte & Touche LLP  
555 Mission Street  
San Francisco, CA 94105  
USA

Tel: +1 415 783 5339  
Fax: +1 415 367 8769  
Email: [wfellows@deloitte.com](mailto:wfellows@deloitte.com)  
URL: [www.deloitte.com](http://www.deloitte.com)

William Fellows is a partner in Deloitte's Financial Accounting, Valuation & Securitization Advisory Practice. He provides trading and structuring desks, accounting policy groups and controllerships with assistance in accounting, valuation and risk management for structured transactions involving securitisations, derivatives, leases, and special purpose entities, under both U.S. Generally Accepted Accounting Principles and International Financial Reporting Standards.

William was also a credit trader at a major investment bank. As a trader, William gained significant experience in the valuation and risk management of complex financial instruments. He also has experience structuring securitised products and interacting with ratings agencies.

William holds an MBA focused on Financial Engineering and Strategy, and a BS in Finance, Accounting and Economics. William is a certified public accountant licensed to practise in California and New York, accredited in business valuation, a chartered financial analyst, and is a certified financial risk manager.



#### Sherif Sakr

Deloitte & Touche LLP  
1633 Broadway  
New York, NY 10019-6754  
USA

Tel: +1 212 436 6042  
Fax: +1 212 653 2314  
Email: [ssakr@deloitte.com](mailto:ssakr@deloitte.com)  
URL: [www.deloitte.com](http://www.deloitte.com)

Sherif Sakr is a partner in Deloitte's Financial Accounting, Valuation & Securitization Advisory Practice. In this role, Sherif provides C-Suite finance and risk executives advisory and consulting services related to accounting, financial reporting, structured finance, treasury operations and risk management where he serves as an advisor to several of Deloitte's strategic global financial services industry (GFSI) clients in both Banking & Securities and Asset Management sectors. He is one of Deloitte's global specialists in areas related to financial instruments, structured transactions, securitisations, consolidations, fair value measurements, derivatives and hedging activities. Sherif is currently a member of Deloitte's Global Banking Leadership Team and the GFSI International Financial Reporting Standards Banking Leader in the United States. In addition to his client service and marketplace responsibilities, Sherif currently serves as the Chief Financial Officer of Deloitte's Advisory business where his responsibilities include financial planning and reporting, data analytics, financial risk management as well as monitoring the strategy execution and the day-to-day business operations.

# Deloitte.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see [www.deloitte.com/about](http://www.deloitte.com/about) for a detailed description of DTTL and its member firms. Please see [www.deloitte.com/us/about](http://www.deloitte.com/us/about) for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.

# US Taxation, Including FATCA, of Non-US Investors in Securitisation Transactions

Ashurst LLP

David Z. Nirenberg



## A. Introduction

This chapter discusses, in plain business English, special US tax rules applicable to non-US investors in securitisation transactions. These rules include, among others, a 30 per cent US withholding tax on non-US investors and the ability of non-US investors to hold securities in bearer form. For a more detailed discussion of the topics covered in this chapter, complete with citations to the relevant primary authorities, readers should see chapter 12 of James M. Peaslee & David Z. Nirenberg, *FEDERAL INCOME TAXATION OF SECURITIZATION TRANSACTIONS AND RELATED TOPICS* (4th Ed., Frank J. Fabozzi Associates 2011) from which this chapter is derived. More information about the book and free updates are available at [www.securitizationtax.com](http://www.securitizationtax.com).

This chapter also discusses the effect on mortgage-backed securities of the Foreign Investment in Real Property Tax Act of 1980 (*FIRPTA*). The chapter finishes with a discussion of the Foreign Account Tax Compliance Act (*FATCA*) rules enacted on 18 March 2010, which generally apply to payments made on or after 1 July 2014. This legislation requires foreign entities to monitor and report on accounts or ownership interests held directly or indirectly by specified US persons. Its purpose is to prevent US persons from avoiding tax by hiding income earned through foreign accounts and entities. Noncompliance is penalised through a special additional withholding tax.

Except where otherwise noted, it is assumed in this chapter that a non-US investor has no connection with the United States other than the holding of the asset-backed security under discussion, and specifically that the investor does not hold the security in connection with a US trade or business conducted by the investor. In very general terms, income of a non-US investor that is effectively connected with a US trade or business is not subject to the 30 per cent withholding tax, but is instead subject to a net income tax at the rates applicable to domestic taxpayers. A non-US investor buying an asset-backed security need not fear that it will be deemed to be engaged in a US trade or business because of activities of the issuer, except in those fairly rare cases in which the issuer is engaged in a US trade or business and the security is treated as a partnership interest.

## B. TEFRA Registration Requirements

### 1. Overview

A debt instrument in bearer form may be transferred by assignment and delivery. Further, the only prerequisite to receiving payments

on such a debt instrument is presentation of the instrument to the issuer (or its paying agent). Thus, the issuer would have no need or ability to track changes in ownership of the instrument. Accordingly, there would be no easy paper trail for the IRS to follow in identifying owners.

With a view to increasing taxpayer compliance, TEFRA amended the Code to prohibit, with limited exceptions, the issuance or holding of debt obligations in the United States in bearer form. Specifically, the TEFRA rules require all *registration-required obligations* (as defined below) to be in *registered form*. (The TEFRA registration requirements are tax-related and distinct from any need to register securities with the Securities and Exchange Commission or state agencies under US securities laws.)

An obligation is in registered form for these purposes if (1) it is registered as to both principal and interest with the issuer or its agent and can be transferred only by the surrender of the old obligation to the registrar for its reissuance, or the issuance of a new obligation, to the transferee, (2) principal and interest may be transferred only through a book entry system maintained by the issuer or its agent, or (3) it is registered as to both principal and interest with the issuer or its agent and can be transferred only through either of the methods described in (1) or (2). Bonds are considered to be in registered form if they are required to be held through a book entry system maintained by a clearing organisation even if holders can obtain physical certificates in bearer form in extraordinary circumstances that are unlikely to occur (specifically, the clearing organisation going out of business without appointment of a successor). Under the Hiring Incentives to Restore Employment Act of 2010 (*HIRE Act*), an obligation issued after 18 March 2012 will also be in registered form if it is held through a “dematerialised book entry system” or any other book entry system specified by the Treasury. Any obligation that is not in registered form is considered to be in bearer form. An obligation is considered to be in bearer form if it is currently in bearer form, or if there is a right to convert it into *bearer form* at any time during the remaining period that it is outstanding.

The issuance of a registration-required obligation in bearer form can result in severe sanctions to the issuer. The issuer of a registration-required obligation in bearer form is liable for an excise tax equal to the product of 1 per cent of the principal amount of the obligation and the number of years (or portions thereof) from its issue date to its maturity date (section 4701) (see Endnote 1). Also, the issuer is not permitted to deduct interest paid on the obligation in computing taxable income or, with limited exceptions, earnings and profits. Finally, obligations issued in bearer form that do not comply with the Eurobond exception (described below) are not eligible for the portfolio interest exemption from the 30 per cent

withholding tax on interest (described below). The sanctions described in the two preceding sentences generally affect only US issuers or issuers that are owned (in whole or in part) by US persons, but the excise tax is potentially applicable to all issuers.

Any US taxpayer that holds a registration-required obligation in bearer form in violation of the TEFRA rules is also subject to certain tax penalties. In general, the holder of a registration-required obligation in bearer form is denied deductions for any loss from the obligation, and any gain from the obligation that otherwise would be capital gain is converted into ordinary income. The holder sanctions apply to an obligation only if the issuer was not subject to the excise tax (described above), and thus are generally a concern only for debt obligations that were issued under the Eurobond exception described below.

A registration-required obligation is defined generally as any obligation other than one that: is issued by an individual; is not of a type offered to the public; or has a maturity at issue of not more than one year. Thus, the TEFRA registration requirements do not apply directly to home mortgages and other consumer receivables that are obligations of individuals. In fact, such obligations are almost never issued or held in registered form. Conventional commercial loans and mortgages are generally not of a type offered to the public and traditionally have been issued in bearer form. However, because interest on bearer securities not issued under the Eurobond exception generally cannot be paid to a foreign holder free of US withholding tax (see below), many commercial loans and commercial mortgages are now issued in registered form.

For purposes of applying the issuer sanctions only, an obligation is not registration-required if it is issued under the *Eurobond exception*, which allows bearer paper to be offered outside of the United States to non-US investors. As discussed below, for obligations issued after 18 March 2012, the Eurobond exception will continue to apply only for purposes of applying the issuer excise tax.

In general, an obligation qualifies for the Eurobond exception if (1) the obligation is “targeted” to non-US investors upon its original issuance, (2) the obligation provides for interest to be payable only outside the United States, and (3) for any period during which the obligation is held other than in temporary global form, the obligation and each coupon contain a *TEFRA legend*. For an obligation to be targeted to non-US investors there must be, in the language of the statute, “arrangements reasonably designed to ensure” that the obligation “will be sold (or resold in connection with the original issue) only to a person who is not a United States person”. To satisfy this arrangements test, generally it is necessary to meet detailed restrictions on offers, sales, and deliveries of obligations during an initial “seasoning” period and to obtain certifications as to the non-US status of investors.

The HIRE Act limited the scope of the Eurobond exception for obligations issued after 18 March 2012, so that it will continue to apply only as an exception to the issuer excise tax. Thus, registration-required obligations issued after that date in bearer form will be subject to the other issuer sanctions (including denial of interest deductions) and will not be eligible for the portfolio interest exemption. What this means in practical terms is that the Eurobond exemption will no longer be available with respect to obligations issued after 18 March 2012, for issuers that are domestic taxpayers or owned by domestic taxpayers because interest on bearer paper would not be deductible.

## 2. Asset-Backed Securities

The TEFRA rules apply in a straightforward way to pay-through bonds, pass-through debt certificates, and REMIC regular interests.

They are registration-required obligations and must be issued in registered form unless the Eurobond exception applies. Although REMIC residual interests are probably not “obligations” for TEFRA purposes, under the REMIC rules, they cannot be issued in bearer form without jeopardising the issuer’s status as a REMIC.

The treatment of pass-through certificates under the TEFRA rules is more complex. Except where otherwise noted, it is assumed in this discussion that the issuing trust is classified for tax purposes as a trust. For substantive tax purposes, pass-through certificates are not recognised to be debt of the issuing trust; instead, they merely evidence ownership of the trust assets. It would make little sense, however, to exclude pass-through certificates from the reach of the TEFRA rules. They are generally liquid securities similar to traded debt instruments. Further, applying a look-through approach would produce odd consequences. The pass-through certificates would not be subject to the registration requirement if the underlying trust assets were obligations of individuals or loans not of a type offered to the public. If the trust assets included any registration-required obligations, it would not be possible to issue certificates in bearer form under the Eurobond exception.

These unsettling results are avoided under regulations that effectively treat *pass-through certificates* (as defined in the regulations) as obligations of the issuing trust for TEFRA purposes. Thus, the nature of the underlying obligations is irrelevant in applying the TEFRA rules to such certificates. The certificates must be in registered form unless the Eurobond exception applies based on an offering of the certificates (as distinguished from the obligations held by the trust) outside of the United States.

The regulations define a “pass-through certificate” as a “pass-through or participation certificate evidencing an interest in a *pool* of mortgage loans” (emphasis added) to which the grantor trust rules apply, or a “similar evidence of interest in a similar pooled fund or pooled trust treated as a grantor trust”. Apart from an example of a trust holding 1,000 residential mortgages, the regulations offer no guidance on the meaning of the term “pool”.

## C. Withholding Tax

### 1. Overview

In general, a non-US investor that receives *fixed or determinable annual or periodical income (FDAP income)* from US sources is subject to a 30 per cent tax on the gross amount of such income, unless either a statutory exemption applies or the tax is reduced or eliminated under an income tax treaty between the United States and the investor’s country of residence. The tax is required to be collected and paid over to the Internal Revenue Service (*the Service*) by any withholding agent in the chain of payment, but is due whether or not it is collected by withholding.

The two types of income that are likely to be earned by an investor in asset-backed securities are interest and gain from the sale or exchange of the securities. Although interest is FDAP income, gain from the sale or exchange of securities, including gain attributable to market discount and option premium, is not. Gain representing accrued original issue discount is treated as interest and thus is FDAP income. Thus, the withholding tax discussion herein concentrates on interest income. Certain other types of FDAP income that may be earned from asset-backed securities are discussed below.

In general, interest income is subject to the withholding tax if it is derived from US sources, unless either the exemption for *portfolio interest* (described below) applies, or the tax is reduced or

eliminated under a treaty. In some cases, tax may be required to be withheld from payments of interest even if those payments are not includible in full in the income of the payee. The investor, however, would be entitled to a refund of any excess tax withheld. Special rules apply to original issue discount, and to dividends paid by a mutual fund out of interest income.

The source of interest income depends on the status of the borrower. Interest is generally US source if the borrower is a resident of the United States or is organised in the United States. Thus, interest on all of the following typically would be sourced in the United States: a pass-through certificate issued by a grantor trust holding obligations of US residents, and pay-through bonds; and pass-through debt certificates that are considered debt of a US resident. Pay-through bonds issued by an entity classified as a partnership would be US source if the entity is engaged in a US trade or business, and bonds of a US grantor trust or disregarded entity would be sourced as if the debt were issued directly by the owner(s).

A specific rule treats excess inclusion income earned on a REMIC residual interest as domestic source income in all cases. Otherwise, there is no explicit source rule for REMIC interests. It is highly likely, however, that income from both regular and residual interests would be sourced in the United States if the issuing REMIC is organised and operated in the United States and the underlying mortgages are obligations of US borrowers. Apart from the source question, the withholding tax applies to REMIC regular interests in the same way that it applies to conventional debt obligations.

Income on a REMIC residual interest representing a share of the REMIC's taxable income is treated as interest for withholding tax purposes. No exemption from such tax or reduction in rate applies to the portion of the income from a residual interest that is an excess inclusion. In the limited cases in which income from a REMIC residual interest is considered to be derived from sources outside of the United States (now only of historical interest for excess inclusion income), such income should not be subject to US withholding tax, even if it is an excess inclusion. The withholding tax generally is imposed on income from a residual interest when such income is paid or distributed (or when the interest is disposed of). Such income may have to be taken into account earlier, under regulations, if the residual interest does not have significant value. Thus far, this grant of authority has been used sparingly, only to require accelerated withholding for partnerships allocating income from residual interests to foreign partners (these rules are described below). Outside of the partnership context, the REMIC regulations prevent under-withholding by providing that a purported transfer of a residual interest to a non-US investor is ignored for tax purposes – with the hapless transferor retaining ownership of the interest for tax purposes – unless the residual interest is reasonably expected to produce cash distributions sufficient to pay withholding tax liabilities no later than the close of the calendar year following the year in which the related income accrues.

For withholding tax purposes, the holder of an equity interest in a domestic partnership or trust is treated essentially as if it owned directly the underlying receivables, and the partnership or trust acts as a withholding agent. Thus, the 30 per cent tax, to the extent it applies, is based on the gross amount of interest received by the partnership or trust. This rule poses a risk for an owner trust that applies interest it receives to pay debt service on pay-through bonds without allowing for a withholding tax. Such a trust and its domestic equity owners have an interest in ensuring that any interest allocable to equity interests held by a non-US investor are exempt from withholding tax, either as portfolio interest or under a tax treaty.

A special withholding regime applies to REMIC residual interests held by domestic partnerships (and certain other pass-through entities) that make it clear that a taxpayer cannot avoid tax on income from non-economic residual interests by having the interests held by a domestic partnership and allocating income from them to foreign partners.

---

## 2. Portfolio Interest Exemption

---

Notwithstanding the general rules discussed above, interest is exempt from withholding tax if such interest qualifies as *portfolio interest*. With limited exceptions – most significantly, for payments of interest to 10 per cent corporate shareholders or partners, to related controlled foreign corporations, or to banks of interest under bank loans, and for certain payments of contingent interest – interest on an obligation (including OID) is portfolio interest if (1) the obligation is in bearer form, and was issued on, or before, 18 March 2012 in compliance with the Eurobond exception to the TEFRA registration requirements described above, or (2) the obligation is in registered form, and the withholding agent receives a statement from the beneficial owner or certain intermediaries giving the owner's name and address and certifying that the owner is not a US person. In the case of an obligation issued prior to 1 January 2009 in "targeted registered" form, a more lenient certification procedure applies if the obligation is held through an appropriate foreign financial institution. In such a case, the financial institution need only certify that the beneficial owner of the obligation is not a US person, without disclosing the beneficial owner's identity. The targeted registered rules have been eliminated for securities issued on, or after, 1 January 2009, although they continue to apply to outstanding securities.

There are three basic approaches to applying the portfolio interest exemption to asset-backed securities, which reflect differences in the degree to which the securities are treated as stand-alone securities or instead as interests in the underlying receivables. This distinction is important because, as noted above, consumer receivables typically are not in registered form and are not issued under the Eurobond exception. Accordingly, interest on such receivables received directly by investors would not be eligible for the portfolio interest exemption. The same may be true for certain short-term debt obligations.

Pay-through bonds and REMIC regular interests are considered debt instruments in their own right and thus can qualify for the portfolio interest exemption based on their own characteristics regardless of the date of origination or bearer or registered status of the underlying receivables. As is true with other debt, the portfolio interest exemption would not apply if the lender was considered a 10 per cent shareholder of the borrower. In applying that limitation, careful consideration should be given to the possible application of conduit principles if the issuer of receivables is related to the lender.

At the other extreme, a full-look-through approach applies to any security that is considered a partnership interest (including interests in most owner trusts and pass-through certificates issued by trusts that have characteristics that prevent them from qualifying as trusts). Thus, the portfolio interest exemption is applied as if the partners owned directly the partnership assets. REMIC residual interests fall into the look-through camp, but are subject to the overriding principle that any income that is an excess exclusion is not eligible for any exemption from withholding tax, including the portfolio interest exemption. Interests in grantor trusts that do not hold "pools" of loans (see the following paragraph) are also subject to a look-through approach.



The last category of securities is pass-through certificates representing interests in grantor trusts holding pools of debt obligations. Although pass-through certificates are generally taxed on a full look-through basis, as discussed above, a special rule treats such certificates as separate obligations for the purposes of applying the TEFRA registration requirements. The same logic carries over to the portfolio interest exemption, so interest received on such certificates is considered to be received on the certificates rather than on the underlying receivables. However, the 18 July 1984 effective date of the portfolio interest exemption is applied based on when the underlying trust assets were issued.

Portfolio interest does not include any interest that, with certain exceptions, is contingent on the profits or cash flow of the debtor (or a related person), the value of the debtor's (or a related person's) property, or distributions on the debtor's (or a related person's) equity. Thus, such interest will generally be subject to the 30 per cent withholding tax unless the tax is eliminated or reduced under a treaty. Of particular relevance to securitisations, the contingent interest exclusion does not apply to interest that is considered contingent solely on account of (1) a contingency as to the timing of any interest or principal payment, (2) the debt being nonrecourse or limited recourse, or (3) the interest being determined by reference to interest that is not itself contingent (or by reference to the principal amount of debt that does not bear contingent interest). While asset-backed securities may provide for payments that depend on cash flows of the issuer, these exceptions cover the features of typical asset-backed securities that are likely to raise questions. Other exceptions are available that are less likely to be relevant in securitisations.

### 3. Swaps, Rents, Options, and Debt-Related Fees

a. **NPC Income.** Some asset-backed securities represent ownership interests in a trust holding both (1) a debt instrument (including a REMIC regular interest) or pass-through certificate, and (2) a notional principal contract (NPC), such as an interest rate swap, cap or floor agreement. The trust may be classified for tax purposes as either a grantor trust or a partnership. The withholding tax treatment of income from the debt instruments held by the trust is discussed above and would not change because the securities are held in combination with an NPC.

The income from payments received on the NPC generally would be FDAP income. Thus, the income would be subject to US withholding tax unless the tax is eliminated or reduced under a tax treaty, or the source of the income is outside of the United States. (The portfolio interest exemption would not apply because swap income is not interest.) In fact, the withholding tax never applies to income from an NPC as such because such income is sourced based on the residence of the payee, not the residence of the payor. However, to the extent there is a significant non-periodic payment under an NPC, the instrument is generally split for tax purposes into an on-market NPC and a deemed loan. If a non-US investor is the lender, the withholding tax treatment of the deemed interest income (specifically whether the portfolio interest exemption or some other relief applies) must be considered separately from the rules for NPCs. There are special rules for dividend equivalent payments on swaps (and other financial instruments) that are not generally relevant to securitisations.

A non-US investor that owns an interest in an NPC through a grantor trust clearly would benefit from the NPC source rule based on the investor's residence, since the trust would be ignored. Due to a change in law in 1997, the result generally would be the same for a non-US investor holding an NPC through a partnership,

provided the activities of the partnership are limited (as they typically are with asset-backed securities in which foreigners invest) to investing and trading in securities.

A credit default swap generally would be considered either an NPC or a put option and payments thereunder would not be subject to withholding tax under either theory (options are discussed below). This statement would not apply, however, to a credit default swap that relates to an identified debt instrument held by the protection buyer if the arrangement were recast as a guarantee. In that case, periodic premium payments made to the protection seller would be subject to the withholding tax rules governing guarantee fees, which generally are less favourable to taxpayers.

b. **Rents.** Rental income from real property located in the United States is considered US source FDAP income. There is no withholding tax exemption for such income comparable to the one for portfolio interest. Thus, if a non-US investor holds pass-through certificates or other equity interests in an entity that is taxed for federal income tax purposes as either a trust or a partnership, and the issuer acquires US real property in connection with a default or anticipated default on a mortgage, the withholding tax generally would apply to the investor's share of any rents received on the property. Interesting allocation issues arise where pass-through certificates are divided into junior and senior classes. On the other hand, income earned on an instrument that is taxed as debt of the issuer, such as a pay-through bond or REMIC regular interest, continues to be interest even if it is derived from rental income. Although uncertain, it appears that all income on a REMIC residual interest would be treated as interest income for withholding tax purposes regardless of the REMIC's sources of income.

c. **Option Income.** Income from options (including gain of an option writer from the lapse of an option) is considered gain from the sale or exchange of property. Accordingly, such income is not FDAP income and is not subject to the 30 per cent withholding tax.

d. **Debt-Related Fees.** A creditor may receive various income amounts denominated as "fees" in connection with extending credit. How withholding tax rules apply to fees received by a non-US person depends on how they are characterised for tax purposes, which should depend on their economic substance. For example, fees may represent interest if paid as additional consideration for lending funds, or may instead be compensation for some ancillary service provided to a borrower and represent income from personal services. Certain fees may be treated as gain from the sale or exchange of property.

Fees that are not gained from the sale or exchange of property would be FDAP income and thus potentially would be subject to withholding tax if received from US sources. The applicable source rule will depend on the type of income involved. Income from personal services is sourced where the services are performed.

In recent years, the Service has issued guidance on a number of miscellaneous types of "fees" charged in connection with credit card accounts, which is helpful in providing a framework for analysing fees. The guidance generally divides the fees between interest and services income depending on whether they are tied to funded amounts. For example, fees charged as penalties for making late payments are interest, and annual fees charged for issuing a credit card (whether or not the card is used) are services income.

Commitment fees are amounts paid by a prospective lender for an agreement of a prospective lender to lend on agreed terms. There are authorities treating such fees in the hands of domestic taxpayers as payments for a property right akin to an option. If this characterisation holds true for withholding tax purposes, income from commitment fees would not be FDAP income, although the point is not clear. Even if commitment fees were considered FDAP

income, they might be sourced outside of the United States on the ground that they are more analogous to gain from the disposition of a property right than to other types of income, or on the ground that the commitment represents a use of the taxpayer's capital which is located outside of the United States.

Fees received for consenting to the amendment or waiver of the terms of a debt instrument would not be FDAP income if the amendment or waiver results in a deemed exchange of the debt instrument, so that the fee is properly considered part of the consideration received in an exchange of the unmodified instrument. Where that is not the case, the outcome depends on whether the fees are properly regarded as additional interest, a fee for services, or compensation for the relinquishment of a property right. The source of the income also needs to be considered.

Fees may be paid to accept credit risk on obligations of a third party. The withholding tax treatment of these fees is currently uncertain.

## D. FIRPTA

FIRPTA subjects non-US investors to US tax on gains from sales of certain United States real property interests (including equity interests in "United States real property holding corporations") in the same manner as if such gains were effectively connected with a US trade or business. The FIRPTA rules do not apply to interests in real property that are solely creditor interests.

If, however, a non-US investor holds a mortgage-backed security taxable as an equity interest in a grantor trust or partnership and the issuer acquires a real property interest in connection with a mortgage default, the investor will generally be treated for the purposes of FIRPTA as owning a non-creditor interest in such property. Any gain attributable to such property that is allocable to the investor will be taxed under FIRPTA, either when the owning entity disposes of the real property, or when the investor disposes of its interest in the entity. A creditor acquiring real property collateral generally would have a basis in the acquired real property equal to its fair market value at the time of acquisition, so that any gain would be limited to increases in the property's value during the period it is held by the entity.

A REMIC regular interest should be treated as a creditor interest that is not subject to the FIRPTA tax without regard to any holdings of real property by the issuer.

## E. FATCA Reporting and Withholding Tax

### 1. Introduction

The FATCA regime was enacted in 2010 by the HIRE Act and is generally effective beginning in 2014. FATCA imposes a 30 per cent withholding tax on withholdable payments made to a foreign financial institution (FFI), whether or not the FFI is the beneficial owner of the payment, unless the FFI enters into an agreement (*FFI Agreement*) with the Service that obligates it, among other things, to report to the Service information about United States accounts, or the FFI qualifies for an exemption from the requirement. FATCA also imposes a 30 per cent withholding tax on withholdable payments made to all other foreign entities (referred to as non-financial foreign entities (NFFE)), provided an NFFE is the beneficial owner of the payment, unless the withholding agent receives a certification as to the ownership of the NFFE by non-US persons.

Currently, the withholding tax will apply to payments made after 30 June 2014. A grandfathering rule provides that withholding is not required for payments in respect of obligations outstanding as of 30 June 2014 and, in the case of obligations that produce only "foreign passthru payments", the date that is six months after the adoption of regulations addressing foreign passthru payments. (The original statutory provisions would have required withholding to apply to payments after 31 December 2012 and the original grandfathering date would have been a much earlier date of 18 March 2012.)

The FATCA withholding tax is not intended to duplicate the regular 30 per cent withholding tax on income paid to non-US investors if it otherwise would apply. Taxes that are withheld may be refunded or credited if the beneficial owner is entitled to a reduced rate of withholding pursuant to an income tax treaty with the United States, or, in the case of a beneficial owner that is an NFFE, it provides certain documentation.

Unlike the conventional rules governing withholding tax on payments to non-US investors, the FATCA regime focuses on payments to foreign entities (not individuals) and has as its goal identifying ultimate US (not foreign) owners of the payments (both individuals and closely held corporations) who may be hiding behind foreign entities. Consistent with this goal, the rules do not generally require the reporting to the Service of income amounts but instead the identities of the US owners and the existence and size of accounts and gross payments. Further, although withholdable payments are limited to payments having, broadly speaking, a US source, the required reporting is not. Thus, an FFI receiving US source payments may be compelled by the threat of withholding on those payments to report on unrelated foreign source income earned by US persons. Congress clearly viewed the withholding taxes as a club to compel compliance with reporting obligations, rather than a new revenue source (aside from the revenue picked up through greater compliance with existing income tax obligations).

The discussion below addresses the statute as modified by the Treasury regulations. The application of FATCA, however, is modified by intergovernmental agreements (*IGAs*) between the United States and various countries around the world. These agreements are intended mostly to address local law restrictions on the gathering or reporting to the Service of account information. They are discussed in Part E.7., below. A brief summary of the IGAs is included immediately below as background for the discussion of the statute and the FATCA regulations.

In 2012, the US released a model IGA (*Model 1 IGA*) for the implementation of a set of rules modifying the application of FATCA to FFIs (*Model 1 FFIs*) resident in countries that enter into bilateral agreements based on the Model 1 IGA (each such country, a *Model 1 Partner Country*). The most significant aspect of the Model 1 IGA is that a Model 1 FFI will not be required to enter into an FFI agreement with the Service. Instead, the Model 1 FFI will be required to comply with the reporting, withholding, and other obligations delineated in the applicable IGA and local non-US legislation implementing the IGA. Two versions of the Model 1 IGA were released – one providing for an automatic reciprocal information exchange by the United States and the Model 1 Partner Country and the other, a non-reciprocal version, providing for a flow of information only to the United States from the Model 1 Partner Country.

In 2012, the US also released a second model IGA (*Model 2 IGA*). The most significant aspect of the Model 2 IGA is that an FFI (*Model 2 FFI*) resident in a country with respect to which a Model 2 Agreement is in place (each such country, a *Model 2 Partner Country*) will be permitted and required by its home country law to register with

the Service by 1 July 2014 and to comply with the requirements of an FFI Agreement. The US Treasury periodically updates the model agreements to incorporate certain modifications arrived at through intergovernmental discussions, as well as modifications to the due diligence procedures to reflect improvements adopted in the final FATCA regulations. The model agreements are available on the US Treasury's FATCA page at <http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx>. The US Treasury has developed different versions of the Model 1 IGA and Model 2 IGA for countries that do and that do not have in place a tax information exchange agreement or double tax convention in effect with the United States.

The United States and the United Kingdom entered into the first IGA, based on the reciprocal version of the Model 1 IGA, on 12 September 2012. The Cayman Islands, one of the most significant places of organisation for offshore securitisation vehicles holding US assets, signed a Model 1 IGA and a new tax information exchange agreement on 29 November 2013. In addition, Ireland and The Netherlands, two of the primary jurisdictions for securitisation vehicles holding European assets, each signed a Model 1 IGA on 23 January 2013 and 18 December 2013, respectively. To date, 22 countries have signed IGAs with the United States.

## 2. FATCA Overview and Definitions

The FATCA rules use a number of defined terms. This summary will begin by defining the most significant terms (as defined in the relevant Code section as modified by Treasury regulations) and then describe the substantive rules for FFIs and NFFEs.

A *withholdable payment* is the kind of payment to which the new withholding tax applies. It is defined as US source FDAP income, and gross proceeds from the sale or other disposition of property of a type which can produce US source interest or dividends (including dividend equivalent payments under swaps). Thus, it includes income amounts not normally subject to withholding tax such as gains on the sale of property and amounts representing a return of capital. There is an exception for an item of income (not payments) effectively connected with a US trade or business.

A *passthru payment* is a withholdable payment or a foreign passthru payment. The foreign passthru payment concept is intended to capture payments by an FFI that are foreign source but attributable to withholdable payments received by the FFI. Although the FATCA regulations have been finalised, the Treasury has deferred drafting a definition of foreign passthru payment. Withholding on foreign passthru payments and the gross proceeds portion of withholdable payments (i.e., obligations of a type that could produce US source interest or US source dividends) has been delayed until 1 January 2017 (and possibly later for foreign passthru payments) from a previously proposed effective date of 1 January 2015. The effective withholding date for any portion of a passthru payment that constitutes US source FDAP income has also been delayed to 1 July 2014. The delayed effective date with respect to foreign passthru payments and gross proceeds is intended to give the Treasury more time to consider how withholding should be applied to such payments. Currently, it is unclear how foreign passthru payment withholding will apply. Previously, the Service had proposed a "US assets based approach" that would have treated a portion of the passthru payment that was not a withholdable payment as US source.

A *withholding agent* is the person required to withhold from withholdable payments and is broadly defined as any person, in whatever capacity acting, having the control, receipt, custody,

disposal, or payment of a withholdable payment or a foreign passthru payment. The term is not limited to US persons.

A *foreign financial institution* or *FFI* is the type of foreign entity that must agree to report on its accounts or suffer withholding on all withholdable payments it receives. Except as provided in an IGA, FFIs generally include the following foreign entities:

- banks;
- broker-dealers and other entities conducting custodial businesses;
- certain foreign insurance companies;
- certain holding companies and treasury centers that are part of financial groups or that are "formed in connection with or are availed of" by investment vehicles;
- entities that conduct one or more of the following activities on behalf of customers: (i) trading in money market instruments, securities, currencies commodities and certain derivative instruments; (ii) portfolio management; or (iii) otherwise investing, administering or managing funds, money or financial assets; and
- professionally managed investment funds (i.e., entities whose gross income is primarily attributable to investing, reinvesting or trading in financial assets) or other entities that function or hold themselves out as collective investment vehicles that are established to invest, reinvest or trade in financial assets (e.g., hedge funds, private equity funds, securitisation vehicles and virtually any other private or widely held investment entity), and generally including an investment fund that uses a professional management entity for any of its assets.

An FFI is generally a *participating FFI* or a *deemed-compliant FFI* if it has entered into an FFI Agreement or is otherwise FATCA compliant (e.g., by complying with the requirements of an IGA or qualifying for special status under the regulations) and otherwise is a *nonparticipating FFI*.

A *non-financial foreign entity* or *NFFE* is any foreign entity that is not a financial institution.

A *financial account* with respect to any financial institution is a depository or custodial account, and also, somewhat surprisingly, certain equity or debt interests in the financial institution, other than interests which are regularly traded on an established securities market. The regularly traded exception requires real trading, not just listing. The FATCA regulations exclude from the definition of financial account plain vanilla debt and equity securities of banks, brokerage firms, investment managers, and insurance companies, even if not publicly traded. This exclusion does not apply if the value of the debt or equity is determined by reference to US assets or the interest is issued with a principal purpose of avoiding the requirements of FATCA. This exception does not prevent the debt or equity that is not considered a financial account from being treated as part of the assets of a custodial account in which it is held and, thus, does not protect it from information reporting (and where appropriate withholding) as an asset of a custodial account.

A *United States account* generally is any financial account held by one or more specified United States persons or United States owned foreign entities. To avoid duplicative reporting, a United States account does not include an account in an FFI if it is held by another FFI that has an FFI Agreement with the Service or if the holder otherwise is subject to information reporting requirements that would make FATCA reporting duplicative. This exception may be very helpful to an offshore issuer in avoiding (or more accurately shifting to others) reporting burdens.

A *recalcitrant account holder* is any holder of a financial account in an FFI which, unless an exemption is available, fails to comply with

reasonable requests to provide information needed for the FFI to determine if the account is a United States account or to meet its FATCA reporting requirements if it is a United States account (including waiving any foreign law that would prevent the FFI from reporting the information).

A *specified United States person* is any United States person with certain exceptions. The exceptions include, most significantly, corporations whose stock is regularly traded and their affiliates, governmental and charitable entities, banks and common trust funds, REITs, RICs and registered broker-dealers. There is no general exception for corporations that do not have regularly traded stock, which is not surprising given the purpose of the statute.

A *United States-owned foreign entity* is any foreign entity with one or more substantial United States owners. A *substantial United States owner* is a specified United States person that has a required ownership interest. The required interest is generally a 10 per cent direct or indirect interest (by vote or value for a corporation and by profits or capital for a partnership). However, for an FFI that is an investment fund or a specified insurance company, any ownership interest is considered to be substantial. For a grantor trust, all specified United States persons who are treated as owners under the grantor trust rules are considered substantial owners. Thus, a foreign trust that primarily holds receivables for investment (and accordingly is an investment fund FFI) and issues pass-through certificates would be required to treat all direct or indirect owners of any certificates that are specified United States persons as substantial United States owners.

An *expanded affiliated group* is a group of corporations (domestic or foreign) connected through more than 50 per cent ownership links, and also includes other entities controlled by members of such a group.

### 3. Foreign Financial Institutions

This section discusses the rules applicable to FFIs. It provides an overview and then discusses special rules to reduce the need for, or burden of, compliance, which unfortunately do not apply to most securitisation vehicles.

a. **Overview.** A withholding agent making withholdable payments to an FFI (other than to an FFI in a Model Partner Country, or an FFI that is exempt from or treated as deemed compliant with FATCA) generally must withhold a 30 per cent tax unless the FFI meets the requirements of section 1471(b) described below. There are exemptions from withholding for interest on short-term debt and on certain nonfinancial payments.

An FFI meets the requirements of section 1471(b) (so that it can avoid withholding on payments it receives) if it registers with the Service pursuant to the procedures prescribed by the Service and agrees to comply with the terms of the FFI Agreement, which will incorporate the requirements set forth in the final FATCA regulations. Very generally, and subject to any differing requirements imposed by a Model 2 IGA, an FFI that enters into an FFI Agreement will be required to do the following:

- withhold on payments to recalcitrant account holders and nonparticipating FFIs;
- obtain information regarding its account holders to determine their FATCA status, including whether such holders are specified United States persons, recalcitrant account holders, or nonparticipating FFIs in accordance with the applicable due diligence procedures;
- report annually to the Service certain information with respect to United States accounts and accounts held by recalcitrant account holders, and where a foreign law would

otherwise prevent the reporting of information with respect to an account, attempt to obtain a waiver of the law or close or transfer the account; and

- adopt a FATCA compliance programme under the authority of a responsible officer, who will be required to certify periodically to the Service on behalf of the FFI.

In the case of an FFI that is a qualified intermediary (*QI*), these requirements are in addition to those imposed under the QI agreement.

There are elaborate rules governing the steps that must be taken by an FFI to determine the status of account holders (with equally elaborate staged effective dates), which are beyond the scope of this discussion.

Subject to an exception for a very limited pool of securitisation vehicles, the requirements of section 1471(b) are not met with respect to an FFI unless they are also met by each FFI that is a member of its expanded affiliated group. Thus, an FFI could go out of compliance if more than half of its equity, by vote and value, were acquired by a corporate owner that is also an FFI but that is not compliant with FATCA. That could be a significant practical issue for a securitisation vehicle having traded equity with a relatively small value.

An FFI must agree to report the following information annually to the Service with respect to each United States account: the name, address, and taxpayer identification number (*TIN*) of each account owner which is a specified United States person (or, in the case of an account held by a United States-owned foreign entity, the entity's name and the name, address, and TIN of each substantial United States owner of such entity); the account number; the account balance or value; and payments made with respect to the account.

The required reporting on account balances, receipts and withdrawals differs from conventional information reporting applicable to US payees of certain categories of income under sections 6041 (FDAP income paid by a business), 6042 (dividends), 6045 (broker reporting of gross proceeds), and 6049 (interest), which requires the reporting of income amounts and sales proceeds. An FFI may elect to report income amounts under these sections rather than account balances and payments on the accounts.

The exclusion from the definition of "United States account" of accounts held by other FFIs with FFI Agreements means that an FFI that cannot practically undertake investor-level reporting obligations (for example with respect to non-traded debt or equity) could avoid them by requiring that debt or equity be held through (1) an FFI that meets the requirements of section 1471(b) and does not elect to pass withholding obligations to its payor FFI, or (2) an NFFE that is a publicly held domestic institution (which would not be a specified United States person). Also, it appears that if all of the debt or equity were held through certain clearing organisations, either no reporting would be required or, if it were required, it would be fairly simple. The FATCA regulations have a reserved section for the treatment of payments to an account held with a clearing organisation with a FATCA-compliant membership.

In August 2013, the Service established an online web portal (available through the FATCA page on the general IRS web site at [IRS.gov](http://IRS.gov)), called the FATCA Registration Portal (*Portal*). An FFI will use the Portal to electronically enter into an FFI Agreement and register its FATCA status with the Service. Once an FFI has registered, it will receive a Global Intermediary Identification Number (*GIIN*). An FFI will be able to avoid FATCA withholding by providing its GIIN to a withholding agent. The withholding agent will confirm the FFI's FATCA status by checking the FFI's GIIN against a list published by the Service.

**b. Rules Limiting FATCA Obligations for FFIs.** Certain categories of FFIs are considered “deemed compliant” and are not required to meet all of the requirements otherwise applicable to an FFI. Unfortunately, there is not a generally applicable deemed compliant category applicable to securitisation vehicles (although those vehicles, like other FFIs, may be subject to more limited requirements under an IGA). There is an exception, described below, for certain limited life debt investment entities or LLDIEs in existence as of 17 January 2013, which is of limited utility, despite the Treasury’s stated intention to expand the scope of the exception. There are deemed compliant categories for certain regulated investment funds (referred to in the regulations as “qualified collective investment vehicles” and “restricted funds”). However, among other requirements, (1) each holder of debt in excess of \$50,000 or of equity in a qualified collective investment vehicle must be a participating FFI, and (2) interests in a restricted fund must be redeemed by or transferred by the fund itself, rather than sold by investors on any secondary market (and there are prohibitions on sales of certain interests in a restricted fund to, among others, certain US persons, nonparticipating FFIs and passive NFFEs).

As noted above, the definition of financial account excludes equity or debt instruments that are traded on an established securities market. In addition, the definition excludes plain vanilla debt and equity securities issued by banks, brokerage firms, investment managers, and insurance companies, even if such interests are not regularly traded on an established securities market. This exception for non-traded debt or equity does not apply to other FFIs, including investment funds and securitisation vehicles.

#### 4. Non-Financial Foreign Entities

Section 1472 requires a withholding agent to withhold a 30 per cent tax from withholdable payments to a NFFE if the beneficial owner of the payment is an NFFE (either the payee or another NFFE) that is not exempt from withholding, unless the withholding agent receives (1) a certification that the beneficial owner does not have any substantial United States owners, or (2) the name, address, and TIN of each substantial United States owner of the beneficial owner. NFFE reporting generally relates to particular payments.

An NFFE is not required to withhold on payments it makes (unless it is otherwise a withholding agent with respect to withholdable payments).

A withholding agent must not know or have reason to know that information it receives is incorrect in order to rely on it. Amounts that are withheld from payments to a NFFE are potentially refundable if the NFFE qualifies for the benefits of an income tax treaty with the United States, the NFFE alternatively certifies that it does not have any substantial US owners, identifies its substantial US owners, or provides documentation establishing that withholding was not required.

Certain NFFEs are exempted from these rules. They include, among others, (1) corporations the stock of which is regularly traded on an established securities market (and their affiliates), (2) “active NFFEs” (entities whose gross income or assets are predominantly non-passive), (3) certain holding companies, treasury centers and captive finance companies that are members of nonfinancial groups, (4) nonfinancial start-up companies, (5) certain nonfinancial entities that are liquidating or emerging from reorganisation or bankruptcy, (6) non-profit organisations, and (7) certain NFFEs that elect to report (either directly or through a sponsor) account holder information directly to the Service.

#### 5. Grandfathered Obligations and Other Transition Rules

The FATCA regulations have grandfathering rules for obligations generally and additional special effective date rules for certain “foreign passthru” obligations, certain debt securitisation vehicles in existence on 17 January 2013, and certain affiliates. There is also a special effective date rule for certain obligations that produce “dividend equivalent” amounts under section 871(m) (such as payments corresponding to dividends under certain equity swaps), but they are not likely to be significant in securitisations.

**a. Generally.** The grandfathering date for withholding has been extended from obligations outstanding on 18 March 2012 (as originally provided in the legislation) to those outstanding on 30 June 2014. While a grandfathered obligation is not subject to withholding, it is generally not exempt from reporting. An obligation will lose its grandfathered status if it is materially modified after 30 June 2014, which for debt instruments means that they are treated as reissued under section 1001. In addition, the FATCA regulations provide that grandfathered obligations include (1) revolving and other lines of credit provided that the applicable agreement fixes the material terms (including a stated maturity date) on or prior to the grandfathering date, and (2) derivatives entered into on, or prior to, the grandfathering date (for this purpose entering into refers to entering into a confirmation, not merely a master agreement). Under a transitional rule for collateral, no withholding is required with respect to a payment made prior to 1 January 2017 by a secured party with respect to collateral securing one or more transactions under a collateral arrangement, provided that only a commercially reasonable amount of collateral is held by the secured party.

**b. Foreign Passthru Obligations.** A grandfathered obligation includes any obligation that produces (or could produce) a passthru payment but cannot produce a withholdable payment, provided the obligation is outstanding on, or before, the date that is six months after promulgation of final regulations defining the term “foreign passthru payment”. This rule applies to obligations that may give rise to foreign passthru payments, but not to withholdable payments. Effectively, the Service took steps to alleviate concerns over potential withholding on foreign passthru payments until it develops and announces a workable definition of the term.

This grandfathering rule is significant for securitisations because it applies to debt securities of non-US issuers (such as foreign corporations issuing CDOs). Accordingly, investors in debt issued by non-US issuers can expect the debt to be grandfathered as long as it is issued before the date six months after the issuance of final regulations defining “foreign passthru payments” (and not materially modified after that date).

**c. Securitisation Vehicles Existing as of 17 January 2013.** Because equity securities never benefit from grandfathering, a special category of deemed compliant FFIs, referred to as limited life debt investment entities (LLDIEs), was established by the FATCA regulations to protect debt securitisation vehicles that were in existence as of 17 January 2013. An LLDIE will be considered a deemed compliant FFI and also will be exempt from the expanded affiliate rule (described below). An LLDIE is an FFI: (1) that does not have authority to enter into, and comply with, an FFI Agreement; (2) that is an investment entity that issued one or more classes of debt or equity interests pursuant to a trust indenture or similar agreement and issued all of those interests on, or before, 17 January 2013; (3) substantially all of the assets of which consist of debt instruments or interests therein; (4) that is required to pay investors holding substantially all of the interests in the FFI all

amounts owed them by a set date or period following the maturity of the last asset held by the FFI; (5) all payments on whose interests are cleared or made through a clearing organisation or a custodial organisation that is a FATCA-compliant FFI or a US financial institution; and (6) was formed for the purpose of acquiring (and did in fact acquire) specific types of indebtedness and holding those assets subject to reinvestment only under prescribed circumstances until maturity. It is not clear whether the references in the regulations to “reinvestment” and “maturity” permit dispositions of an asset held by the FFI before the asset’s maturity but any other reading would be nonsensical.

d. **Expanded Affiliate Rule.** As indicated above, an FFI will be unable to enter into an FFI Agreement unless each member of its expanded affiliated group enters into its own FFI Agreement. The FATCA regulations provide a two-year transition, until 1 January 2016 (which is permanent in the case of FFIs in countries with intergovernmental agreements in place and for FFIs that qualify as LLDIEs), for the full implementation of this requirement. During this transitional period, the existence of an FFI affiliate in a jurisdiction that prohibits the reporting or withholding required by FATCA will not prevent other FFIs within the same expanded affiliated group from entering into an FFI Agreement, provided that the FFI in the restrictive jurisdiction agrees to perform due diligence to identify its US accounts, maintain certain records, and meet certain other requirements.

## 6. Use of US Withholding Agents as Blockers

The Treasury and the Service have indicated that they are aware of the potential for using US withholding agents as blockers for foreign passthru payments made to nonparticipating FFIs. The potential arises because US withholding agents are required to withhold only with respect to withholdable payments while a participating FFI (generally, an FFI that has entered into an FFI Agreement or is otherwise FATCA compliant) may be required to withhold on all payments. In light of the potential for abuse, the Treasury and the Service have announced that they are assessing various options to address this issue, including expanding the scope of payments that US withholding agent must withhold on, or requiring FFIs to withhold on passthru payments made to US withholding agents acting as intermediaries. To date, no specific rule has been announced although the technical rules of who is treated as a payee may limit some of the more egregious schemes.

## 7. Intergovernmental Agreements

As discussed above, the United States has entered into a number of IGAs based on the Model IGAs, and expects to enter into many more. There are two Model IGAs, 1 and 2, and several variations within the models. Also, the model agreements are periodically updated (most recently in November 2013) to reflect changes in the basic FATCA rules and negotiations with other governments. The models have a clause allowing a signatory to get the best deal allowed under agreements with other countries. The Model 1 IGA and Model 2 IGA are discussed in the next two sections.

a. **Model 1 IGA.** Under an intergovernmental agreement based on the Model 1 IGA (a *Model 1 Partner FATCA Agreement*), a Model 1 FFI will not be required to enter into an FFI agreement with the Service. Instead, a Model 1 FFI will be required to comply with the reporting, withholding, and other obligations delineated in the agreement. Instead, the FATCA compliance requirements will be mandated under each Model 1 Partner Country’s internal laws. This approach should resolve any concerns on the part of an FFI that

reporting and withholding undertaken comply with local laws (including privacy laws), and also ensures that any withholding will be required “pursuant to law” of the Model 1 Partner country, as that term is used in transactional documents.

Model 1 FFIs generally will still be required to conduct due diligence to identify their direct and indirect US account holders and to report on those accounts to the Model 1 Partner Country, which will then report such information to the United States. However, the requirements may be less burdensome than those required by the FATCA regulations absent an IGA. In general, the diligence rules will be more closely aligned to existing practices.

Model 1 FFIs will be required to withhold on, or collect, certain information with respect to accounts held by certain nonparticipating FFIs. Model 1 FFIs will not, however, be required to withhold on payments to, or close accounts held by, non-FFI account holders that fail to comply with requests for identifying information, provided that the Model 1 FFIs report on such accounts to their own governments. Further, Model 1 FFIs are not required to withhold on payments of US source passive income made to non-participating FFIs, provided that the Model 1 FFI provides its immediate payor with the information required for the payor to perform the necessary withholding and reporting. However, Model 1 FFIs that are acting as qualified intermediaries and that have assumed US withholding and reporting responsibilities with respect to an asset will be required to withhold on payments on such asset.

The Model 1 IGA delays withholding for non-US source income and US source gross proceeds until an agreement is reached between the governments at some time in the future. It is unclear if a future agreement will modify, and if so, to what extent, the withholding obligations of Model 1 FFIs on payments of such other amounts to nonparticipating FFIs. This approach parallels the general approach of the proposed regulations with respect to foreign source passthru payments.

A Model 1 FFI that fails to meet the reporting, withholding, or other requirements of the relevant Model 1 Partner FATCA Agreement may be designated after notice from the IRS as a nonparticipating FFI, and, therefore, becomes subject to FATCA withholding.

The reciprocal version of the Model 1 IGA requires the United States to pursue legislative and administrative actions to achieve reciprocal and automatic exchanges of information between the United States and a Model 1 Partner Country with respect to accounts maintained by US financial institutions.

A modified affiliate rule effectively adopts as a permanent rule the transition rule in the FATCA regulations that allows affiliated FFIs to not comply with FATCA in full if they are not allowed to do so under local law. This protection will not extend to other affiliated FFIs that are not themselves Model 1 FFIs.

As indicated above, under the FATCA regulations, debt or equity of banks, investment managers, insurance companies and custodians institutions will not be subject to FATCA reporting and withholding unless the value of the debt or equity is determined by reference to US assets or the interest is issued with a principal purpose of avoiding the requirements of FATCA. The Model 1 IGA, however, requires that both conditions be met (i.e., references US assets and issued with a bad purpose) in order to fall outside the exception. This expanded exception will ease somewhat the FATCA-related requirements for many structured notes issued by financing subsidiaries of banks.

Annex II of the Model 1 IGA identifies country specific categories of exempt beneficial owners or FFIs or categories of financial accounts and products that will be exempted from reporting under the IGA.

b. **Model 2 IGA.** The Model 2 IGA is similar to the Model 1 IGA except that instead of reporting to its home country revenue service, a Model 2 FFI will be permitted and required by its home country law “to register with the IRS by 1 July 2014 and comply with the requirements of an FFI agreement . . .”.

Because an agreement patterned on the Model 2 IGA requires direct reporting of information to the Service, the Model 2 IGA requires each Model 2 FFI as a condition of opening a new account to obtain consent of each holder of a new account that is identified as a US account to report information to the Service. A similar requirement applies to new accounts of nonparticipating FFIs where the Model 2 FFI expects to pay a “foreign reportable payment” (a payment of FDAP income that would be a withholdable payment if it were paid from sources within the United States). In addition, a Model 2 FFI must request consent of pre-existing account holders to report to the Service. In order to encourage pre-existing account holders to consent, each Model 2 FFI must also inform pre-existing account holders that even if an account holder does not consent, the Service can request and obtain information about the account from the Model 2 Partner Country’s revenue service.

A Model 2 FFI generally will not be required to withhold on payments to a recalcitrant holder. However, unlike the Model 1 IGA where the requirement for such withholding has not yet been determined, the Model 2 IGA does not suspend the requirement to withhold on payments to nonparticipating FFIs.

The Model 2 Agreement does not provide for reciprocity. It does, however, indicate that the United States is willing to negotiate a reciprocal obligation subject to a determination that the standards of confidentiality and other prerequisites for cooperation are fulfilled.

## Endnote

1. Except as otherwise noted, all section references are to the US Internal Revenue Code of 1986, and references to regulations are to the Treasury Regulations promulgated thereunder. This chapter is current through 28 February 2014. For more updated information on the topic, please see the updates to chapter 12 of James M. Peaslee and David Z. Nirenberg, *FEDERAL INCOME TAXATION OF SECURITIZATION TRANSACTIONS AND RELATED TOPICS* (Frank J. Fabozzi Associates 2011), available free of charge at the website for the book: [www.securitizationtax.com](http://www.securitizationtax.com).



### David Z. Nirenberg

Ashurst LLP  
Times Square Tower, 7 Times Square  
New York, NY 10036  
USA

Tel: +1 212 205 7007  
Fax: +1 212 205 7020  
Email: [david.nirenberg@ashurst.com](mailto:david.nirenberg@ashurst.com)  
URL: [www.ashurst.com](http://www.ashurst.com)

David Z. Nirenberg is a partner in the international finance department in New York. He covers the tax aspects of securitisations, structured products and finance, derivative products and investment funds and has played a significant role in the structuring of a wide variety of innovative financial products in both domestic and cross-border markets.

David has written and lectured extensively in the area of financial products. He is the co-author of *FEDERAL INCOME TAXATION OF SECURITIZATION TRANSACTIONS AND RELATED TOPICS* (4th Ed., Frank J. Fabozzi Associates 2011 with periodic updates). More information about the book is available at: [www.securitizationtax.com](http://www.securitizationtax.com).

David is admitted to the Bar of New York.

- Columbia Law School (JD).
- Boston University (MBA).
- Cornell University (BS).

# ashurst

Ashurst is a leading international law firm advising corporations, financial institutions and governments. We have 28 offices in 14 countries as well as an associated office in Jakarta, and a best-friend referral relationship with an Indian law firm. With over 400 partners and 1,700 lawyers in total, we offer the international insight of a global network combined with local market knowledge.

With over 40 attorneys in the US, our core businesses include structured finance (including CLOs), derivatives and derivative products, structured products, leveraged finance, general corporate, real estate, infrastructure (“P3”), tax planning, and financial regulatory.

Ashurst’s structured finance practice offers specialist advice across a range of securitised products. Ashurst is uniquely placed to offer an integrated service in structured finance and securitisation restructurings, drawing on the strengths of its network and its other market-leading tax, regulatory, and restructuring groups. Products Ashurst covers include CLOs (including the use of both synthetic and funded structures), consumer finance securitisation, CMBS, receivables based financings, municipal bond and lease securitisation repackagings, and whole business securitisation. Ashurst also has extensive experience in derivatives, including bespoke credit and equity derivatives transactions, and working with distressed securitisations, including CDOs and CLOs.

# Debt Trading: A Practical Guide for Buyers and Sellers

Berwin Leighton Paisner LLP

Paul Severs



The continued constraints on the securitisation market have meant that financial institutions have had to look to different exit strategies for loans and other assets on their balance sheets and this trend has continued over the past 12 months. In addition to financial institutions divesting large loan and bond portfolios, there has been notable activity from European asset management agencies, such as NAMA, IBRC and SAREB. Of particular note are the high profile commercial and residential mortgage loan portfolio sales by IBRC known as Projects Rock, Salt, Sand, Stone and Pebble which have engaged a significant number of market participants this year looking to acquire and finance the portfolios. In addition, the sale by Eurohypo of a EUR5bn commercial loan book comprising a performing and sub performing pool (sold to Wells Fargo and Lonestar respectively) and the sale by Deutsche Postbank of a *circa* GBP1.3bn portfolio of performing commercial real estate loans (sold to GE Capital) have dominated the market in the last 12 months.

A broader buyer universe has developed, with a significant number of US investors entering the market. In addition to a significant number of transactions in the UK, Ireland and Germany, attention is starting to turn to other markets such as Spain, Italy, The Netherlands and the Nordic region. It has also been interesting to see market participants looking at structured finance exits for the financing of the portfolio acquisitions, with several participants looking at CMBS as an exit route.

In addition to the bank sector, the CMBS sector continues to provide significant opportunities for the acquisition of debt and underlying assets as the maturity date of the loans passes and the maturity date of notes approaches, thereby limiting the ability to extend the loans.

Opera Finance (Uni-Invest), a securitisation collateralised by Dutch commercial real estate, was the first European CMBS to default at note level (in February 2012) after a failed attempt to sell the underlying property companies. TPG and Patron Capital, advised by Berwin Leighton Paisner, proposed an innovative structure to the Class A Noteholders (who controlled the enforcement process) to buy out the debt from the securitisation. The structure involved paying down 40 per cent of the principal amount of the Class A Noteholders while rolling the remaining 60 per cent debt owed to the Class A Noteholders into a new deal secured on the same underlying properties for a term of five years. All other creditors in the transaction structure were wiped out. TPG and Patron Capital also acquired the equity in the underlying borrower.

The execution of debt sales, whether by balance sheet lenders or within the framework of structured finance transactions, such as Uni-Invest, requires a clearly defined process and data with integrity. Buyers have tolerance thresholds, both in terms of the

quality of due diligence information and discount to face value, which has been illustrated by some unsuccessful divestment projects which have come to market.

In this chapter, we consider some of the key issues arising from debt portfolio sales, from the perspective of sellers and purchasers of debt and third party financiers funding the purchase, based on our recent experience of advising different participants in the market.

## The Auction Process

The process for soliciting interest and bids for loan sales takes many forms with varying degrees of formality. Where large portfolios are being sold, typically, a formal auction process will be run. While the specific process will vary, typically there are two phases to the auction process: Phase One, where an initial round of bidders are invited to perform initial due diligence for the purposes of submitting an indicative price or range of prices; and Phase Two, where a small number of bidders progress to more detailed due diligence and finalisation of pricing. During Phase Two, bidders are also typically provided with *pro forma* sale and purchase documentation and they provide a mark-up of the documents with any comments/amendments when they submit their final bid. The overall intention of the seller is to maintain competitive pressure throughout the sale process and prevent the situation where a buyer can renegotiate the price at the last minute.

The process tends to take a different form where the auction is in the context of a structured finance transaction as distinct from an outright sale by a balance sheet lender. In a structured finance transaction, where the sale is at loan level, the “seller” will typically be the special servicer (acting as agent of the issuer), whereas if the sale is of the loan (i.e. as a result of a default at the note level), the sale will be by the security trustee for the Noteholders acting at the direction of the holders of the most senior class of notes. In both situations, there are overriding express or implied fiduciary duties of the seller which can influence aspects of the auction process.

## Data Room Content and Rules

The starting point for an auction process is assembling the information by reference to which bidders will undertake due diligence. The information is collated in a “data room” which is typically a website to which bidders will be given online access. Usually, the bidders in Phase One will be given limited access to the data room and the Phase Two bidders will be given full access.

To assist the seller and its advisors in managing the auction process, there will be a set of rules by reference to which access to



information is provided and which set out the process and procedures for the auction. If a bidder breaches the rules, it can result in exclusion from the auction process and, potentially, contractual liability.

The data room will usually comprise a data tape with loan and asset level data, legal documentation related to the loans (loan agreements, amendment agreements, guarantees, security documents, legal opinions etc.). An up-to-date complete and accurate data tape is critical to the process, because a significant part of the pricing analysis undertaken by buyers is based on this data. Any errors in the data tape are likely to undermine the bidders' confidence in pricing and could lead to price renegotiation or bidders withdrawing from the process.

It can take time to compile the data room, particularly because some sellers have incomplete/missing documentation. An important aspect of the data room is formatting and indexing the files in which the loan level information is held in a clear and coherent "user-friendly" manner. Purchasers will be reluctant to engage in the due diligence process if they enter the data room and are confronted by hundreds of PDF documents which are not clearly identified and they have to engage in a voyage of discovery as to the identity and relevance of each document.

As an initial step in preparing the data room, the seller's legal advisers will need to carefully review confidentiality provisions of loan agreements and other information (such as third party reports) and ensure that any consents to disclosure are obtained. Non-disclosure and confidentiality agreements will typically be signed with bidders as a precondition to access to the data room and are thus a preliminary part of the auction process.

Where the sale is related, either directly or indirectly, to listed securities, the data room may be divided between information that is in the public domain and information that is not in the public domain. Information that is not in the public domain could constitute non-public price-sensitive information. Access to such information would prevent the bidder buying or selling the securities. In these circumstances, there needs to be a clear process for cleansing such information.

## Due Diligence

The scope of due diligence varies according to the type of assets that are being purchased (whole loans, A/B split loans, performing/non-performing notes, X notes, etc.), the basis of the pricing decision, scope of representations and warranties being provided by the seller, the amount of data captured by the seller and the integrity of the seller's records and systems.

By way of example, the due diligence for a non-performing portfolio may differ from the due diligence for a performing portfolio. The due diligence for the former focusing mainly on the value of the collateral and the security package in the context of the buyer's enforcement strategy rather than any detailed consideration of the terms of the loan agreement.

Some of the key areas for consideration as part of the due diligence processes are:

1. **Data Tape:** The verification of the information captured on the data tape back to the source is a critical part of the due diligence process. This is so particularly in the case of granular assets, such as residential mortgage portfolios and consumer loans, where portfolio-based valuation and pricing will be used. For example, the interest data generated will be based on algorithms that calculate the interest to be applied to the loan balance; this needs to be verified to ensure that the calculations are in accordance with the loan documents.

2. **Collateral:** The underlying collateral is key to the value of the assets being acquired. For real estate collateral, due diligence would include title/ownership verification, zoning permissions, assessment of value, assessment of the physical condition (including machinery and equipment), leases and rent roll.

3. **Origination Due Diligence:** Original appraisal reports and other commercial and legal underwriting due diligence undertaken at the time of the origination of the loan may be made available, although the value of some elements of this will depend on the time elapsed since origination. Disclosure of these types of reports may require adherence to non-reliance letters. It is unlikely that reliance can be placed on these and disclosure may also be restricted.

4. **Security:** A detailed security review will be undertaken to ensure appropriate security exists in respect of the relevant assets and such security is binding and enforceable. In the context of non-performing loans, the type of security will influence the work-out strategies. The security needs to be reviewed by legal counsel to verify its integrity and assess the range of enforcement methods including the time and cost implications for any enforcement to determine the appropriate enforcement strategy.

5. **Regulatory Compliance:** Some classes of assets are heavily regulated both with respect to the terms upon which they are originated and the way in which enforcement and collections are undertaken. This is particularly relevant in the context of consumer assets (residential mortgages, second liens, small unsecured consumer loans, point of sale credit and credit cards). Non-compliance with the relevant regulatory requirements can lead to the relevant loan being unenforceable as well as regulatory sanctions being applied to the owner of the debt.

6. **Waterfalls:** A careful review of pre- and post-enforcement cash flows and the accounts through which revenue and principal receipts pass is critical to understanding potential recoveries. In the current interest rate environment, there are many out of the money swaps which are secured and rank equally with the debt, which can materially dilute recoveries in enforcement situations. Of particular focus is the extent to which there is scope for leakage by way of fees and expenses to both borrower group companies and third parties.

7. **Enforcement and Insolvency Regimes:** A clear understanding of the enforcement process (including time period and costs of enforcement) applicable in each country where any secured asset is located, is important. Many countries have court-based auction processes which tend to be lengthy and relatively expensive. This needs to be taken into account in assessing the expected returns to any purchaser. Germany, in particular, has potentially lengthy court-based insolvency proceedings which directors may initiate to the detriment of creditors. In contrast, the UK has a simple and creditor-friendly enforcement regime.

8. **Counterparty Credit Risk:** Transactions may have multiple layers of counterparty credit risk, as illustrated by the insolvency of Lehman Brothers. Much emphasis was placed on reviewing the performance of collateral on the Lehman securitisation programmes (such as Eurosail and Windermere), but when Lehman became insolvent, the primary issue for the securitisations and investors in lower tranches of securitised debt was the termination of the currency swaps that Lehman had entered into with the securitisation vehicles. Other counterparty risks include tenants, bank accounts, bank liquidity facilities and undrawn commitment on facilities, property managers and the agent. The insolvency of Lehman Brothers highlights that assumptions regarding the solvency of any counterparty need to be carefully examined.

9. **Counterparty Performance Risk:** Many asset pools have counterparties performing functions that are integral to the ongoing performance of the assets and debt (such as collection agents,

managing agents, servicers, etc.). The ability of these parties to terminate their contracts on enforcement (insolvency is a typical termination right) and the ability for a creditor to step in, needs to be assessed. Also, the quality and expertise of individuals, investment in training and quality of systems and data need to be carefully reviewed and underwritten. In particular, when dealing with granular portfolios (such as residential mortgages and credit cards) the operating software systems need to be assessed for compatibility with the purchaser's systems and ownership of the source code and object code verified, together with a review of any related software licences.

10. **Intercreditor Rights:** A careful understanding of the terms of any intercreditor agreement is important when buying a position in any debt that has been tranching through intercreditor arrangements. Any restructuring of the debt is likely to require the consent of parties to the intercreditor (and the beneficiaries under any security trust arrangements). The circumstances when cash flows are switched (cash trap and/or full cash sweep) are often embedded in the terms of intercreditor arrangements. Typically, swaps are correlated to each tranche of debt and thus, where buying mezzanine or junior debt, the terms of any senior ranking swaps, potential volatility and the timing of termination become very relevant.

11. **Loan Agreement:** The terms of the loan agreement and related documents are fundamental to the assessment of the asset being acquired. Specifically, when cash flows are blocked from flowing to equity, the operation of financial and other covenants and associated grace and cure periods all need to be fully understood. A point that needs to be checked carefully is the distinction between an "event of default" and "acceleration". An event of default gives rise to the right to demand immediate repayment of the outstanding debt and does not necessarily automatically trigger an obligation to repay. In some loan agreements, cash trap and cash sweep provisions are triggered by an event of default and, in others, by acceleration. Many deals closed at the height of the cycle were less than perfectly documented and thus a careful review of the terms of the documents is essential.

12. **Voting Rights:** If a buyer is not acquiring the full capital structure, a clear understanding of voting rights needs to be understood. In loan agreements and bond transactions, certain matters may require an ordinary majority (over 50 per cent), some require an extraordinary majority (66<sup>2</sup>/<sub>3</sub> per cent or 75 per cent) and some matters may require unanimity. The voting rights need to be understood across the entire capital structure. The terms of the debt need to be reviewed in conjunction with any intercreditor agreements that may modify the voting position between the lenders. With respect to voting rights in bond transactions and noteholder meetings, it is essential to review the trust deed rather than rely on the terms and conditions that are reproduced in the prospectus, as experience has shown that reliance cannot always be placed on the completeness of the summaries of documentation or loans in the prospectus. There is a concern as to the extent to which underlying documents can be regarded as "in the public domain" and whether this triggers insider trading concerns. Therefore, legal advice on this is necessary.

The level of legal due diligence undertaken by the seller's legal counsel varies. However, at a minimum, the seller's legal counsel will need to check certain key items in the loan and security documentation for the purposes of the sale, including confidentiality provisions and assignability. When advising sellers, we would usually work with them at an early stage in the process to identify whether there are any issues with the assets which could impact on the sale process and may have a material impact on pricing, so that they can be highlighted to buyers or separately

addressed at an early stage to avoid nasty surprises arising which are detrimental to the sale process.

Buyers will also typically undertake their own legal due diligence. Although some asset warranties are usually provided by the seller, depending on the transaction, the scope of these may be relatively limited and it is standard for there to be limitations on the seller's liability (see further below). The level of due diligence undertaken by the buyer therefore depends, to some extent, on the seller warranty package and recourse, but also on the nature of the portfolio and enforcement strategy and may also be partially driven by the requirements of any financiers who will be funding the acquisition.

### Loan Purchase Documentation

The documentation for the acquisition of loans or securities varies from deal to deal, depending on the type of asset being sold and the commercial objectives of the buyer and seller. Some of the key provisions of sale and purchase documents are:

1. **Assets:** If loans or securities are being sold, then the core assets subject to the sale are the rights under the loan documentation (or the terms and conditions of the notes) and the security related to the debt and recourse under that security (ultimately the collateral that is subject to the security). The security may include the mortgage or other fixed security on the main collateral (residential or commercial real estate, projects and concession agreements associated with projects, ships, aircraft, etc.), bank accounts, share charges, guarantees, assignments of insurance and recourse against advisers engaged in underwriting (valuers, lawyers, etc.). Where the debt is structured as a syndicated loan or a note, then the security will typically be held by a trustee on trust for the benefit of the creditors under the loan or note issue. From a legal perspective, additional complexity arises where the security for the asset is in the form of "all monies charges" which secure all the debt of the original lender to the borrower from time to time, particularly where the seller is selling some, but not all, of the debt owed by the borrower. In such circumstances, the seller may use a sub-participation, swap or trust arrangement to pass on the benefit of the debt, and thereby retain the benefit of the all money security with respect to the debt which it is retaining.

2. **Warranties:** The buyer will seek warranties related to the seller and the underlying assets being acquired. With respect to warranties related to the seller, these will cover usual matters such as due incorporation and its ability to enter into documentation which is legal, valid and binding. Additionally, in light of the downfall of Lehman Brothers, even when buying from large well-established institutions, representations and due diligence as to solvency are essential. With respect to the assets, the approach will depend on the basis upon which the transaction is undertaken. As mentioned above, some transactions are undertaken with very limited warranties and buyers are given full access to data and expected to undertake detailed due diligence. On other transactions, buyers are provided with less data and sellers provide comprehensive warranties. The scope of warranties and level of due diligence undertaken may impact upon the purchase price. Where pricing is driven off key data in the data tape, warranties as to the accuracy of specified fields of data together with appropriate due diligence can be critical. Where dealing with granular assets, such as residential mortgage loans, the risk of systemic error should be considered and addressed, either through warranties or by way of due diligence. In our experience, the negotiation of warranties and limitations with respect to breach can be protracted. As a general approach, a buyer should request, and a seller should expect to give, certain standard representations and warranties. These include that

the account balances and key financial information are correct, the debt constitutes a legally binding obligation and the existence and validity of underlying security. Sellers will usually need to undertake a verification exercise to ensure the warranties they give are true and that there is no retained risk arising as a consequence of giving such warranties.

3. Limitations on Recourse for Breaches of Warranties: The right to bring a claim for breach of warranty will be restricted by a series of specified limitations. These will include the time period within which a claim must be made (e.g. 12 months to 36 months), maximum liability (typically a percentage of the purchase price) and minimum amount of the claim (e.g. exclusion for small claims). The buyer will be expected to take proper steps to mitigate any loss and the seller may have the right to take over any loss mitigation strategy. Most importantly, claims will be barred for disclosures made in the disclosure letter provided with respect to the representations and warranties. The disclosure letter is a critical document in defining the potential scope of liability and the basis of disclosure should be clearly understood prior to embarking on the sale process.

4. Remedy for Breach: The remedy for breach is typically a form of monetary claim based on damages or an indemnity. The concept of damages as a remedy is, in principle, simple and the scope of contractual damages is a tried and tested area of English law. The main issue in portfolio sales in using damages as a remedy is whether the measure is by reference to an individual asset or the portfolio as a whole. From a seller's perspective, damages should be defined as the loss (or reduction in value) in the portfolio as a whole arising from the specific breach. From the buyer's perspective, they will seek to apply the test on an asset by asset basis. A buyer's remedy may include a put option whereby the buyer can put the asset back on the seller at the purchase price (or by reference to an agreed formula) if there is a breach. Put options are "clean", but not consistent with the seller's (usual) objective of exiting a position permanently and are therefore rarely seen in current transactions. However, call options are now often included, so that if a breach of warranty claim is initiated by a buyer, the seller has the option to repurchase the relevant asset rather than pay a claim based on damages (or indemnity).

## Financing

There are two main forms of financing: vendor financing; and third party financing. Vendor financing is made available to purchasers of debt by the seller of the debt. From the start of the financial crisis until around 2011 there was very limited third party financing and thus transactions were financed either with vendor financing or entirely with equity. There were notable exceptions, principally where purchasers were major institutions with strong banking relationships. In the current market, there are several financial institutions who will provide financing to purchasers. Typically the finance is in the region of 50 per cent to 60 per cent of the acquisition costs. There have been higher advance rates, but this comes at a cost.

The recent Uni-Invest transaction was a good example of a new form of vendor financing. The securitisation had defaulted and the class A Noteholders became the controlling party for enforcement purposes. The class A Noteholders accepted a proposal from TPG and Patron Capital whereby the purchase price paid was 40 per cent cash and 60 per cent debt in a new funding arrangement secured on the assets. This financing enhanced the ability to sell the assets at a price that, in aggregate, was equal to the balance outstanding on the class A Notes.

More generally, both the vendor and the purchaser can reap benefits from the vendor providing a percentage of the purchase price. Advantages include widening both parties' potential customer base and relationships, lowering the cost of obtaining credit facilities in comparison to usual sources with potentially lower all-in funding costs, and reducing the acquisition costs by sharing them between both parties. Vendor financing has also been secured with limited recourse to the particular assets concerned rather than on the purchaser's own assets and equity.

There are, however, some disadvantages. The granting of credit will result in risk with respect to the asset being retained on balance sheet and consequential associated regulatory capital requirements (which become even less attractive under Basel III). The vendor will still incur the ongoing costs of managing and accessing the assets within the portfolio whilst it will still bear some of the risk involved if, for example, the loans go into default or the borrower becomes insolvent. In view of the current poor credit market conditions, many purchasers may choose not to take the asset as well as counterparty risk no matter how attractive the terms of the vendor financing may be.

Vendor financing can be structured in many ways. Examples of vendor financing include equity but with a fixed return and a payment-in-kind (PIK) note which ranks behind bank debt with the intention of it being repaid when the asset is sold and the structure is unwound, but will be repaid ahead of equity. Parties are also prepared to stagger any financing, such that any vendor financing may amortise towards the maturity of the loans or be subordinated to other positions in the capital structure.

Key considerations for third parties providing finance are:

- Exit strategy: the financier may need the transaction to comply with certain requirements to facilitate the desired exit (e.g. syndication, securitisation or other means).
- Retention and due diligence requirements under the Capital Requirements Regulation: the financier will need to be comfortable that the financing is not caught by the "securitisation" requirements of the Capital Requirements Regulation or that it complies with such requirements. Although the financing structure may not be a structure which one would typically consider to be a securitisation, the definition of a securitisation for the purposes of the regulation is intentionally broad and each structure must be analysed on a case-by-case basis to determine whether there is contractual subordination and an allocation of losses over the life of the transaction which triggers the requirements of the regulation. Failure to comply with the regulation could result in a EU credit institution being subject to a high regulatory capital charge on its holding of the loan and may impact the lender itself or its ability to sell on the loan in future. Similar requirements apply to lenders which are funds under the Alternative Investment Fund Manager Directive and will also be introduced for insurance companies when Solvency II comes into force. Thus, advice from regulatory experts is required in relation to any loan on loan financing.
- Servicing and control: the financier will need to be comfortable with the business plan for the assets being acquired and will want a level of control over actions to be taken with respect to the assets. In addition, the financier will usually have the right to "step in" and control the servicing of the assets in certain circumstances.

## Flexibility and Innovation

The structure of the acquisition and the holding of debt securities/loans going forward will be driven by those sellers that

are able and want to execute a clean break (and can afford to take any losses resulting from the sale price being lower than book value) and those that either do not want to or are unable to undertake a clean sale and thus retain a participation in the future cash flows derived from the assets.

Within this context, broadly, two themes or types of transaction are developing in the market: straight sales and “structured sales”. A straight sale is simply an arm’s length sale to a third party with complete risk transfer with respect to the assets and typically very limited warranties and no vendor financing. Structured sales involve an arrangement where the seller retains some economic interest in the performance of the collateral that is “sold” and may not constitute a significant risk transfer. The retained interest may be structured through deferred consideration mechanics or a promotion based on exit values or through a more complex joint venture arrangement with a retained position in the entity acquiring the assets.

The objectives of the “structured sale” vary, but typically include some of the following: retention of upside with a cap on downside risk; bridging the gap between the book value and market value (through instruments such as deferred consideration); creating liquidity through the use of forms of “collective investment” arrangements; creating an alignment of interest with an asset manager and equity; and partial balance sheet “de-recognition”. European banks are increasingly looking at innovative solutions that include these types of features in the context of overall asset (balance sheet) reduction strategies.

An example of such innovation is Project Isobel. Isobel was a sale by RBS of a portfolio of UK corporate real estate and operating company/property company loans to a newly created fund vehicle. RBS took a majority stake and Blackstone a minority stake in the investment vehicle which was established under the UK corporate securitisation tax regime. Blackstone was also appointed as asset manager, partly reflecting its expertise in the operating business sectors. The transaction was designed to maximise recoveries on the loans and create liquidity in an otherwise illiquid loan book, thus attracting pools of capital that would not otherwise invest in complex loan assets, harness the expertise of professionals highly experienced in working out complex loans and assets; align the interest of the work-out professionals with those of the bank; and retain upside from the creation of value while preserving future liquidity. The unique and innovative features of the transaction include:

1. the appointment by a UK bank of a globally reputed institutional asset manager with extensive expertise in the real estate classes forming collateral for the underlying loans to both manage the real estate loan portfolio and to source meaningful equity investment for the fund vehicle through its access to institutional capital;
2. investment holdings in Isobel are structured in a form which is easily transferable and investable, providing RBS with flexibility regarding the sale of its holding;
3. reduction of RBS’s exposure to the highly leveraged loans (including longer dated loans) which form part of the portfolio while benefiting from future recoveries (maximised through Blackstone’s active asset management) on the portfolio;

4. a UK resident structure is used to hold the loans; and
5. the structure takes account, and mitigates the impact, of derivatives (including several long dated derivatives).

The transaction structure is capable of being tapped and replicated for other loan portfolios and provides a model for future transactions in the market for banks seeking liquidity for their legacy loan assets.

## Tax

The tax treatment of acquiring and holding distressed debt needs to be neutral (at worst) and advantageous (at best) for sellers and buyers. In “neutral” structures, the key drivers are:

1. no transfer taxes on moving the debt securities into the new ownership structure;
2. no material tax leakage at either the asset holding or investment vehicle levels;
3. ensuring investors/buyers pay no more tax in the structure than if they were to hold the underlying securities directly;
4. minimising cash flow taxes during the buyer’s period of ownership; and
5. achieving an exit from the new structure which attracts no more tax than a comparable direct holding and sale of the securities.

Structures with a greater degree of tax planning may also seek to:

6. ensure tax relief is available to the seller for the “distressed” bit of the single asset or portfolio sold;
7. defer or eliminate a charge to tax on the “pull to par” or “part discount” component of the distressed assets over time;
8. segregate assets with attractive tax attributes into separate pools; and
9. give buyers/investors a better tax treatment in relation to their participation than a comparable direct holding and disposal of the underlying assets.

## Conclusion

With the quantum of money looking to be deployed by the funds sector and the increased capital requirements in the banking sector leading to the contraction of balance sheets in the banking sector, asset debt sales are set to continue for the foreseeable future. In a low interest rate environment, many funds with appropriate expertise can achieve attractive returns for investors buying loan assets at a discount but still representing an attractive exit for the bank.

The buying and selling of debt involves a clear understanding of the overall market and market-related issues, the normal process used for auctioning debt, the approach to due diligence and the legal documentation for effecting the sale and perfection of the interests transferred. Also of importance is a clear understanding of the tax and regulatory issues from both a buyer’s and seller’s perspective.

**Paul Severs**

Berwin Leighton Paisner LLP  
Adelaide House, London Bridge  
London, EC4R 9HA  
United Kingdom

*Tel:* +44 20 3400 4626  
*Email:* paul.severs@blplaw.com  
*URL:* www.blplaw.com

Paul has been involved in the European debt markets since the mid-1980s. He has more than 25 years' experience in structured finance, debt trading and work outs. He has advised extensively on both the buy side and sell side as well as on note holder steering committees, lenders, swaps providers, collateral managers, special servicers and insolvency practitioners. Most recently Paul has advised on many of the high-profile loan trades and restructurings including Uni-Invest (Dutch commercial real estate), Centaurus and Infinity Soprano (German multifamily), Tahiti (hotels), The Mall (shopping centres) and Isobel (mixed commercial loans). He has worked extensively with funds and co-investors establishing appropriate structures for acquiring and holding assets and advised on promote and inventive arrangements for asset managers and management teams.

In addition to debt trading Paul has worked with funds establishing new debt origination platforms as funds have entered the direct lending market across a range of assets classes.

Paul has extensive experience across a range of assets classes including commercial and residential mortgages, infrastructure debt, consumer loans, auto loans and equipment leases. Geographically Paul has advised on transactions throughout Europe and Asia.



The Securitisation and Structured Finance team at BLP comprises structured finance experts with a complementary mix of excellent technical skills, industry experience and market know-how. Our team has a growing reputation for delivering first rate legal advice to major clients in the industry. We have a genuine understanding of the commercial drivers, concerns and ambitions of our clients and market participants.

# Securitisations in the Shadows of the New Capital Regime

Shearman & Sterling LLP



Bjorn Bjerke



Azad Ali

### Introduction

The current capital framework for securitisations under the Basel standards is principally set out in the Basel II Accord [see Endnote 1] albeit the original Basel I framework [see Endnote 2] had some impact on the securitisation market. Securitisations began to be used as a tool to address the crude credit risk weightings set out in Basel I. Subsequent revisions to the Basel standards introduced detailed and extensive treatment of securitisations. This chapter will look at some of the key elements of the securitisation framework under the Basel standards including revised standards that are currently being proposed by the Basel Committee [see Endnote 3], particularly in the context of securitisation as a viable financing technique to efficiently manage bank balance sheets. First, however, the chapter will analyse the definition of securitisations, and the key differences between the types of securitisation for the purposes of the capital regime.

### Some Important Terms

The Basel securitisation framework describes a securitisation exposure as one assumed not only by asset-backed securities (ABS) investors but also by originators, sponsors, as well as liquidity providers and providers of credit enhancement. Basel II makes a distinction between “traditional” and “synthetic” securitisations [see Endnote 4]. These definitions are effects-based and wide enough to capture structures that are not normally considered to be securitisations. At the heart of both definitions is a requirement that a tranching securitisation exposure is serviced by, and dependent on, the cash flow from underlying exposures and not dependent on the obligation and credit of the originator, and that the tranches represent different degrees of credit risk [see Endnote 5]. The Basel III definition is tied to a tranching exposure to a “pool” of underlying exposures. The “pool” requirement is not included in the rules as implemented in the U.S. Instead, the U.S. rules provide for various features that must be present for an exposure to fall within the securitisation framework. In addition to tranching, such additional features include that: (i) all or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties other than through the use of credit derivatives or guarantees; (ii) the performance of the securitisation depends on the performance of the underlying exposures; (iii) all or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities); (iv) the underlying exposures are not owned by an operating company, small business investment company, or a firm in which an investment would qualify as a

community investment; and (v) the transaction is not an investment fund, collective investment fund, employee benefit plan, synthetic exposure to capital to the extent deducted from capital under the capital regime rules or a registered fund under the 1940 Act [see Endnote 6]. Similar exemptions from the securitisation framework exist in implementing rules in the UK where single-asset structures, and “specialized lending” such as certain project and asset financings fall outside the securitisation framework.

That the definitions are effects-based is confirmed by the need for “supervisors [to] look to the economic substance of a transaction to determine whether it should be subject to the securitisation framework for the purposes of determining regulatory capital” [see Endnote 7]. The U.S. rules similarly specify that the relevant regulatory agency may deem certain, otherwise excluded, transactions to be a securitisation based on its leverage, risk profile or economic substance notwithstanding certain exceptions that otherwise would apply [see Endnote 8]. The distinction between covered securitisation exposures and tranching exposures that fall outside the definition is, therefore somewhat diffuse at the margins.

The definition of “synthetic securitisation” is based on the transfer of tranching credit risk to an underlying exposure by means of a derivative or guaranty or similar instrument rather than transfer of the ownership to the underlying exposure itself [see Endnote 9]. The Basel definition further requires the credit risk to tie to “at least two different stratified risk positions or tranches” [see Endnote 10], whereas under the rules as implemented in the U.S., a synthetic securitisation is focused on the transfers of exposures to financial assets and specifically excludes guarantees of single corporate loans. Synthetic securitisations have the benefit of permitting banks to continue to maintain the ownership of its assets and address any adjustments required for the risk transfer in a separate agreement with the counterparty. A credit default swap (CDS) or a credit-linked note (CLN) or similar unfunded or funded instrument are both examples of synthetic securitisation that could be used to transfer the risk to a counterparty under Basel standards.

The distinction between a senior tranche and a junior tranche is also relevant to the capital treatment of securitisation exposures. The senior tranche benefits from the payment stream from the entire securitised pool ahead of other debt tranches. The Basel Committee is currently proposing standards which would clarify that the senior tranche is not required to be the most senior claim in the waterfall (i.e., certain expenses and hedging costs may be paid before the senior tranche without thereby jeopardising the seniority of the tranche) although if the senior derivative were to be based on the credit performance of the underlying pool rather than being an interest or currency hedge, logic dictates that the derivative would be viewed as a tranche that is senior to other tranches.

The Basel 2.5 standards (which revised the Basel II framework for securitisations) introduce a further differentiation between regular securitisations and resecuritisations. The latter is defined as the securitisation of a securitisation exposure. Examples of resecuritisation exposures given in the U.S. final rules include securitisation of residential mortgage-backed security (RMBS) exposures and of assets that include another securitisation exposure. Resecuritisations are subject to much higher capital requirements, and the justification is said to be the increased complexity, opacity and correlation concerns associated with the underlying exposures. What this doesn't capture are "[e]xposures resulting from retransching [which] are not resecuritisation exposures if, after retransching, they act like a direct tranching of a pool with no securitised assets" [see Endnote 11]. The U.S. rules exclude retransching of a single exposure from the definition of resecuritisation, which is potentially somewhat narrower. As such, retransching could potentially be used to adjust the risk level of an exposure (but without falling under the securitisation framework) by adding additional subordination to the original tranching.

### Other Important Rules and Requirements

It is worth noting at this stage several other significant recent and forthcoming rules that will potentially impact banks' ability and willingness to engage in securitisations. For example, revised and more detailed disclosure requirements such as those likely to be proposed under revised Regulation AB on the one hand may present a vehicle to obtain detailed information required for banks to apply their Internal Ratings Based Approach (IRBA) models and conduct their required due diligence but may also present important confidentiality challenges. Restrictions on banking entities from having "ownership interests" in funds that fall within the "covered fund" definition of the Volcker rule will likely impact the composition of securitisations such as CLOs since loan-only securitisations are excluded from the "covered fund" definition. Proposed conflicts of interest restrictions may impact the manner in which banks effectuate securitisations, especially synthetic securitisations and EU risk retention requirements will impose punitive capital charges on banks and certain other financial institutions if the securitisation does not comply with the requirement that an eligible entity must retain 5 per cent. of the credit risk [see Endnote 12].

The restrictions on relying on external ratings under Section 939A of the Dodd-Frank Act has amongst its consequences that the external ratings-based approach is not available in the U.S. which could result in significantly increased capital charges for certain securitisations.

Also worth noting is the treatment of securitisation exposures held by non-banks. For example, in the EU, insurance companies gearing up to comply with a revamped capital regime (known as "Solvency II") will face stricter capital charges on their securitisation exposures. More broadly, the current reform agenda for "shadow banking" activities are tabling proposals which include, among other changes, restrictions on the ability to re-hypothecate client collateral and minimum haircuts on securities collateral, and would accordingly have an impact in terms of the use of ABS as collateral. Neither do ABS figure as a component of High Quality Liquid Assets necessary to meet the Basel III Liquidity Coverage Ratio (apart from a small proportion of high quality RMBS).

In addition, rules imposing collateral requirements for non-centrally cleared OTC derivatives exposures are in various stages of adoption

and such requirements will likely have a direct impact on synthetic securitisations. Such collateral requirements also add to the drivers creating a demand for high quality, acceptable, collateral and the extent to which securitisations can be used to create such acceptable collateral will directly impact demand and liquidity for the product.

### The Evolution of the Securitisation Framework

Before delving into the detail of the treatment of securitisations under the Basel standards, it is worth briefly summarising how the securitisation framework has evolved to where we are today. The initial Basel Accord, referred to as Basel I [see Endnote 13], applied a "one size fits all" approach to credit exposures which failed to give adequate capital relief for highly rated exposures. Since highly-rated, and therefore lower yielding, collateralised debt attracted the same capital charges as lower-rated collateralised debt, banks were incentivised to optimise their balance sheet through securitisations. By selling assets to a securitisation vehicle, banks could improve their capital ratios while capturing a large portion of the yield on the transferred assets. For example, by selling \$1,000 of assets to a securitisation vehicle and taking back a \$500 junior securitisation exposure, the bank would have reduced its credit exposure by \$500 freeing up the unnecessary capital required to be held against the senior slice of the exposures while capturing the yield of the entire pool in excess of what was required to be paid to the holders of the \$500 senior tranche.

The shortcomings of Basel I and the increasingly widespread recognition of the use of securitisation as a means to allocate risk and capital efficiently resulted in a specific framework for the treatment of securitisation exposures within the Basel II Accord, which was adopted in 2006. The Basel II capital rules prescribed significantly reduced capital charges to highly rated securitisation tranches while increasing the capital charges for the lower rated tranches. The capital charge reductions attracted considerable anxiety in some quarters and the adoption of Basel II regime for securitisations in the U.S. was slow for that reason. Changes in the capital weighting for the senior tranches brought about by Basel III is quite marked as illustrated (in respect of the U.S.) in Table 1 [see Appendix 1].

In the aftermath of the financial crisis, the general consensus amongst regulators was that the assigned risk weights were too low, especially in the case of resecuritisations. The Basel Committee therefore introduced new standards that formed part of Basel 2.5, for enhancing the Basel II securitisation framework. In particular: (a) higher risk weights were required for resecuritisation exposures under both the IRBA and the Standardised Approach (SA); (b) banks were prevented from using ratings based on guarantees or support by the bank itself; (c) certain due diligence requirements were a prerequisite for using the risk weights specified in the Basel II framework failing which a penal 1,250 per cent. risk weight or deduction from capital was required; (d) the credit conversion factor for liquidity facilities used to support securitisations was increased to 50 per cent. regardless of maturity (liquidity facilities with less than one year maturity had received a credit conversion factor of 20 per cent. under the SA); (e) the circumstances where liquidity facilities could be treated as senior securitisation exposures was clarified; and (f) favourable treatment of market disruption liquidity facilities was eliminated.

The Basel II regime, together with the Basel 2.5 revisions, has been strongly criticised for relying too mechanistically on external ratings. The currently proposed revisions are comprehensive and seek to reduce the reliance on such ratings. In the U.S., as reliance on external ratings for relevant purposes is no longer permitted, the

External Ratings Based Approach (ERBA) to determine risk weights will not be possible. However, where permitted, the ERBA is still useful as a measure to compare how the risk weights associated with securitisation exposures are changing in response to the experience of the financial crisis.

Basel 2.5 imposes a 1,250 per cent. risk weight if the bank is unable to perform adequate diligence on the underlying exposures, and this concept is carried through to Basel III [see Endnote 14]. The level of diligence required is such that the bank on an on-going basis must have a comprehensive understanding of the risk characteristics of its individual securitisation exposures and the risk characteristics of the pools underlying its securitisation exposures. “Banks must be able to access performance information on the underlying pools on an on-going basis in a timely manner. Such information may include, as appropriate: exposure type; percentage of loans 30, 60 and 90 days past due; default rates; prepayment rates; loans in foreclosure; property type; occupancy; average credit score or other measures of creditworthiness; average loan-to-value ratio; and industry and geographic diversification.” And “for resecuritisations, banks must obtain information on the characteristics and performance of the pools underlying the securitisation tranches” [see Endnote 15].

The Basel proposals are set out in a consultative paper issued in December 2013 [see Endnote 16] which builds on the prior consultation from December 2012 [see Endnote 17]. The comment period for the current consultation closed on 21 March 2014. The tightening of risk weights that was proposed in the first Basel Committee consultation has been scaled back somewhat in the most recent proposal. As often is the case after a crisis, the initial inclination tends towards overcompensating for past excesses. In the most recent consultation, the pendulum has swung back to a degree and concessions have been made to relax some of the more stricter parts of the previous proposals. As such, the risk weight floor for the most highly rated securitisation exposures have been increased from 7 per cent. currently to a proposed 15 per cent. in the most recent Basel Committee consultation [see Endnote 18]. It is worth noting that in the U.S., current rules implement a 20 per cent. floor [see Endnote 19].

The current Basel proposal aims to address shortcomings of the current standards by: (1) reducing mechanistic reliance on external ratings; (2) increasing risk weights for highly-rated securitisation exposures; (3) reducing risk weights for low-rated senior securitisation exposures; (4) reducing cliff effects; and (5) enhancing the framework’s risk sensitivity by applying a more granular calibration of risk weights [see Endnote 20].

For securitisations other than resecuritisations, the proposal mandates the following hierarchy of methods for determining the risk weight of a particular securitisation exposure:

- if the bank has the capacity and requisite regulatory approval, it may use an IRBA model to determine the capital requirement based on the credit risk of the underlying pool of exposures, including expected losses;
- if the IRBA cannot be used for a particular securitisation exposure, if permitted within the relevant jurisdiction (noting that external ratings cannot be relied on in the U.S.) the bank may use the ERBA which has been recalibrated and become more granular compared to the ratings-based risk weights in the current and past Basel regimes as outlined in Table 2 [see Appendix 2];
- if neither of these approaches can be used, the bank would apply the Standardized Approach which applies a risk weight based on the underlying capital requirement that would apply under the “standardized approach” for credit risk, and other risk drivers [see Endnote 21]; and

- if none of these three approaches can be used, then the bank must assign a risk weight of 1,250 per cent. to the exposure.

For resecuritisation exposures, the only available approach is an adjusted version of the Standardized Approach or, if that approach cannot be used, assignment of a risk weight of 1,250 per cent. “This reflects the Committee’s view that resecuritisations are inherently difficult to model.” [See Endnote 22.] A further approach, the Internal Assessment Approach (IAA) applies to banks providing liquidity facilities and credit enhancements to asset-backed commercial paper (ABCP) programmes where the bank is a sponsor. Where an ABCP conduit has an external rating, any unrated exposures of the bank can qualify for the IAA with the result that the bank can apply an inferred rating to exposure derived from the commercial paper issued under the ABCP programme.

Generally the IRBA would be expected to generate less stringent capital requirements than the more crude ERBA and the SA. However, a recent industry comment letter has demonstrated how in many situations the mandated IRBA resulted in a much higher risk weight than the ERBA [see Endnote 23]. The industry comment letter also argues that the Basel proposals assigns too high of a risk weight compared to the historical loss experience for most asset classes. Especially in the U.S., the instances where the ERBA produces lower risk weights will potentially put U.S. banks at a competitive disadvantage.

Whether a bank can, and is permitted to, calculate the rating equivalent based on an IRBA, depends in part whether the bank has an approved internal ratings-based model that can apply to the underlying exposures and also whether the bank has the required information on the underlying exposures.

The types of features that may render a securitisation ineligible for the IRBA as mentioned in the recent Basel Committee consultation include tranches for which credit enhancement could be eroded for reasons other than portfolio losses, transactions with highly complex loss allocations and tranches of portfolios with high internal correlations (such as portfolios with high exposure to single sectors or with high geographical concentration) [see Endnote 24].

Banks located in jurisdictions that permit the use of an ERBA may do so if the relevant tranche of the securitisation has an actual or inferred external rating from at least one rating agency, if not based on a guarantee or similar support provided by the bank itself [see Endnote 25].

### Securitisation Features Likely to Change with the Shifting Regulatory Landscape

The changes to the capital regime will likely result in the disappearance of certain securitisation features and in the emergence of others.

One obvious change driven by the revised capital rules will be that resecuritisations in the form of collateralised debt obligations (CDOs) and other similar structures may lose their appeal entirely. As pointed out in some post-crisis literature, much of the securitisation demand was driven by an active repo market, where highly rated paper was in high demand for use as collateral in that market with the result that CDOs of securitisations came to be used as a means to “slice and dice” normal securitisations and create additional highly-rated paper in the process [see Endnote 26]. However, given the large risk weights assigned to resecuritisation exposures and the inability to use the IRBA for such exposures, the demand for such securities will likely be greatly reduced. On the other hand, retransching may be increasingly used to adjust the credit risk of a securitisation exposure to the optimal level for



capital purposes without being captured by the stricter treatment assigned to resecuritisations.

The Basel Committee does not take into account any credit enhancements provided by insurance companies predominantly engaged in the business of providing credit protection (such as monoline insurers). Furthermore, the possibility that ratings ascribed to such enhancements may push the relevant exposure out of being able to rely on the ERBA will likely negatively impact demand for such guarantees or credit enhancements. Credit enhancements that effectively come from the bank itself also will be discounted and may not be taken into account as part of the ERBA. For example, a rating agency may ascribe a ratings enhancing effect to a bank's liquidity facility or other support for a securitisation. However, in determining its own risk weight for such exposure the bank is not permitted to rely on the credit enhancing effect of such support. There will still be a demand for credit enhancements, especially if such enhancement satisfies the criteria that it will not be eroded other than for reasons relating to losses in the underlying exposures. It is likely that other qualifying guaranty providers will step into the space left behind by the monoline insurers to provide certain credit enhancements.

The information required for a bank to use the IRBA coupled with the due diligence requirement, incentivise simplicity in terms of the underlying assets, as well as in terms of the waterfalls and various triggers. As pointed out in the latest Basel Committee consultation: "A bank must have a thorough understanding of all structural features of a securitisation transaction that would materially impact the performance of the bank's exposures to the transaction, such as the contractual waterfall and waterfall-related triggers, credit enhancements, liquidity enhancements, market value triggers, and deal-specific definitions of default." [See Endnote 27.] Similarly, in the U.S. the due diligence requirement dictates that "the banking organization's analysis would have to be commensurate with the complexity of the exposure and the materiality of the exposure in relation to capital of the banking organization" [see Endnote 28].

The increased need for information about the underlying exposures driven by the IRBA and the due diligence will likely drive significantly increased disclosure requirements. Numerous legislative proposals are currently leading to enhanced disclosures in the space, but for the most part these proposals are aimed at providing information at the level usually required by investors. Banks will likely have a more granular requirement driven by the inputs required for use of the IRBA.

### Balance Sheet Optimisation

As outlined above, securitisations became an important tool to maximise capital relief in response to the insensitive risk-weightings under Basel I by allowing banks to tailor tranches with variable risk/return characteristics. The evolution of securitisations, particularly synthetic securitisations, were influenced by the need of banks to retain the ownership of the underlying exposures while transferring the credit risk, and therefore reducing capital charges.

Securitisations are likely to continue to play an important role as a balance sheet optimisation tool, and the revised capital regime and various post-crisis rules and restrictions will significantly shape securitisation structures going forward. However, it is worth noting that while senior securitisation tranches tend to have comparatively lower risk weights, junior tranches tend to have relatively higher risk weights.

The U.S. operational requirements for transferring credit risk using a traditional securitisation are that: (a) the exposures are not reported on the bank's consolidated balance sheet under GAAP; (b)

the bank has transferred the credit risk associated with the underlying exposures to third parties; (c) any clean-up calls must meet the eligibility criteria outlined above; and (d) the securitisation may not: (i) include revolving credit lines as underlying exposures; and (ii) contain any early amortisation provision.

The operational requirements for transferring credit risk using a synthetic securitisation require (a) an acceptable credit mitigant (which are: (i) financial collateral; (ii) eligible guarantees; and (iii) eligible credit derivatives), and (b) transfer the credit risk to third parties on terms that do not: (i) allow for the termination of the credit protection due to deterioration in the credit quality of the underlying exposures; (ii) require the bank to alter or replace the underlying exposures to improve the credit quality of the underlying exposures; (iii) increase protection costs to bank or increase yield to counterparty in response to deteriorating credit quality of the underlying exposures; or (iv) provide for increases in any first loss or other credit enhancement provided by the bank. In addition the bank must obtain a "well-reasoned opinion from legal counsel confirming the enforceability of the credit risk mitigant in all relevant jurisdictions"; and any clean-up calls relating to the securitisation must be: (1) eligible clean-up calls (i.e. exercisable solely at the discretion of the originating banking organisation or servicer; (2) not structured to avoid allocating losses to securitisation exposures held by investors or otherwise structured to provide credit enhancement to the securitisation); and (3) exercisable only when 10 per cent. or less of principal amount of the reference portfolio remains [see Endnote 29].

In order for a bank to recognise the credit mitigating effect of a synthetic securitisation, it has to comply with the requirements set out in the applicable implementing law. The bank must either hold risk-based capital against any credit risk of the exposures it retains in connection with a synthetic securitisation or, alternatively, choose not to avail itself of the credit enhancement and instead hold risk-based capital against the underlying exposure as if the synthetic securitisation had not occurred.

For synthetic securitisations, a fully paid CLN will result in a full transfer of the risk without any further capital charges. On the other hand, a CDS that is not fully collateralised or collateralised with assets that are subject to a risk weighting factor greater than zero will introduce risk either to the counterparty or to the underlying collateral. However, even if the risk is transferred for the purposes of reducing risk-weighted assets, the reference assets under such synthetic transactions would continue to be included in the banks' leverage ratio calculations [see Endnote 30] as the assets remain on the bank's balance sheet so such transactions therefore do not provide full relief from the Basel III ratios. The conflicts of interest rules introduced under the Dodd-Frank Act also limit banks' ability to sponsor synthetic securitisation transactions linked to assets on the banks' balance sheet. Consequently, it is likely that traditional securitisations will figure more heavily as a means of balance sheet optimisation.

Traditional securitisations where the banks transfers assets and hold on to a securitisation exposure will remove assets from the banks' balance sheet and are therefore also effective in providing relief under the leverage ratios. Under the U.S. standard, the originating bank must have transferred the credit risk of the underlying exposure to third parties. In the EU, regulators will only recognise the underlying assets as having transferred if one of the following two conditions are satisfied: "(a) significant credit risk associated with the securitised exposure is considered to have been transferred to third parties; [or] (b) the originator institution applies a 1250 per cent. risk weight to all securitisation positions it holds in [the applicable] securitisation or deducts these securitisation positions

from Common Equity Tier 1 items ....” [see Endnote 31]. Given the penal rate of 1,250 per cent. risk weight, the second option is hardly viable and the key, therefore, lies in determining what constitutes significant risk transfer. The EU rules set out in the EU Capital Requirements Regulation (No 575/2013, the “CRR”) gives two examples: (a) where the originator holds a mezzanine position (within the meaning of the CRR) for which the risk weighted exposure does not exceed 50 per cent. of the risk weighted exposure of all mezzanine transactions; and (b) in a securitisation without a mezzanine tranche, the originator does not hold more than 20 per cent. of the 1,250 per cent. securitisation exposures and such exposures exceed expected loss by a substantial margin [see Endnote 32]. In other circumstances a substantial risk may be viewed as transferred if the originator can demonstrate in every case that the reduction of regulatory capital is justified by the transfer of credit risk to third parties.

## Conclusion

The Basel III framework, including the leverage ratio and net stable funding ratio, pressure banks to shed long-term assets and reduce risk-weighted assets overall. Capital requirements also drive divestitures but can be more readily managed by changing the credit quality of the underlying assets. Traditional securitisations provide a means for both removing assets from the bank’s balance sheet and transforming the credit quality of the retained securitisation exposures. Market pressures are therefore such that the banks will be incentivised to shift assets and risks to markets with less stringent capital rules.

Despite other legislative initiatives that may significantly impact securitisations, such as risk retention requirements, and extension of capital requirements and liquidity and leverage constraints beyond the traditional banks to the so-called “shadow banking” sector, securitisations would still provide capital efficiencies by allowing banks to originate various underlying exposures, transfer the bulk of its exposures to non- (or less) regulated parties wishing to take the credit risk on the underlying exposures.

The shift towards non-bank lenders and less regulated participants is coupled with increased demands for high-quality collateral. As confidence in the securitisation market returns, it is reasonable to predict that demand for senior securitisation exposures for use as collateral in other trading contexts, at least in well performing, familiar and established asset classes, will rebound and complement the banks’ need to sell assets to remain in compliance with their capital regime.

## Endnotes

- 1 Basel Committee document: “International Convergence of Capital Measurement and Standards” (June 2006), available at: <http://www.bis.org/publ/bcbs128.pdf>.
- 2 Basel Committee document: “International Convergence of Capital Measurement and Capital Standards” (July 1988), available at: <http://www.bis.org/publ/bcbs04a.pdf>.

- 3 Basel Committee, “Consultative Document: Revisions to the Basel Securitisation Framework” (December 2013), available at: <http://www.bis.org/publ/bcbs269.pdf> at 21.
- 4 *Ibid* 1, at 120.
- 5 *Ibid* 1, Chapter IV.
- 6 Final Rules at Section \_\_.2, 78 Fed. Reg. 62018 , 62169 (11 October 2013).
- 7 78 Fed. Reg. at Section \_\_.2.
- 8 *Ibid* 3, at 21 & 78 Fed. Reg. at Section \_\_.2.
- 9 *Ibid* 1, paragraph 539.
- 10 *Ibid* 1.
- 11 *Ibid* 3, at 21.
- 12 The EU Capital Requirements Regulation (No 575/2013), Articles 404-409, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0001:0337:EN:PDF>.
- 13 *Ibid* 2.
- 14 Basel Committee: “Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems”, available at: <http://www.bis.org/publ/bcbs189.pdf>.
- 15 *Ibid* 3, at 28.
- 16 *Ibid* 3.
- 17 Basel Committee (First) Consultative Document: “Revisions to the Basel Securitisation Framework” (December 2012), available at: <http://www.bis.org/publ/bcbs236.pdf>.
- 18 *Ibid* 17.
- 19 78 Fed. Reg. at 62119.
- 20 *Ibid* 3, at 3.
- 21 *Ibid* 17.
- 22 *Ibid* 3, at 6.
- 23 Joint Associations’ response to the second Consultative Document on Revisions to the Basel securitisation framework, dated 24 March 2014.
- 24 *Ibid* 3, at FN 9.
- 25 *Ibid* at 5.
- 26 See, Gary Gorton & Andrew Metrick: Securitised Banking and the Run on Repo (9 November 2010), available at: <http://ssrn.com/abstract=1440752>.
- 27 *Ibid* 3, at 28.
- 28 78 Fed. Reg. at 62114.
- 29 *Ibid* 14, note that the Basel Committee has calibrated the leverage ratio as the ratio of Tier 1 capital to non-risk weighted assets which should exceed a 3 per cent. minimum.
- 30 *Ibid* 12, Section 2, Article 243(1).
- 31 *Ibid* at Article 243(2).
- 32 *Ibid* at Article 243(4).

## Appendix 1

Table 1. Ratings-based risk weights for Basel regimes leading up to Basel III.

Long-Term Ratings	Pre-Base I US Rules	Risk Weights Under Base I Final Rules			Risk Weights under Basel 2.5 for Resecuritisation Exposures	
		Granular Pool		Non-Granular Pool	Senior Exposure	Non-Senior Exposure
		Senior Exposure	Non-Senior Exposure			
AAA	20%	7%	12%	20%	20%	30%
AA	50%	8%	15%	25%	25%	40%
A+		10%	18%	35%	35%	50%
A		12%	20%		40%	65%
A-		20%	35%		60%	100%
BB	100%	35%	50%		100%	150%
BBB		60%	75%		150%	225%
BBB-	200%	100%			200%	350%
BB+		250%			300%	500%
BB		425%			500%	650%
BB-		650%			750%	850%
B, below or unrated	Gross up	Deduct from tier 1 and tier 2 capital				
Short-Term Ratings						
A-1	20%	7%	12%	20%	20%	30%
A-2	50%	12%	20%	35%	40%	65%
A-3	100%	60%	75%	75%	150%	225%

## Appendix 2

Table 2. External Ratings Based risk weights associated with senior tranche securitisation exposures under Basel III compared to the current Basel 2.5 framework.

Rating	External Ratings-Based Approach (2nd consultative document)		Revised Ratings-Based Approach (1st consultative document)		RBA (current framework)	
	Maturity		Maturity		Maturity	
	1 year	5 years	1 year	5 years	1 year	5 years
AAA	15%	25%	20%	58%	7%	7%
AA+	15%	35%	32%	75%	8%	8%
AA	25%	50%	51%	97%	8%	8%
AA-	30%	55%	61%	110%	8%	8%
A+	40%	65%	71%	124%	10%	10%
A	50%	75%	81%	141%	12%	12%
A-	60%	90%	94%	162%	20%	20%
BBB+	75%	110%	106%	183%	35%	35%
BBB	90%	130%	118%	203%	60%	60%
BBB-	120%	170%	136%	235%	100%	100%
BB+	140%	200%	153%	265%	250%	250%
BB	160%	230%	170%	294%	425%	425%
BB-	200%	290%	210%	363%	650%	650%
B+	250%	360%	262%	442%	1,250%	1,250%
B	310%	420%	321%	485%	1,250%	1,250%
B-	380%	440%	389%	502%	1,250%	1,250%
CCC [+/-]	460%	530%	472%	568%	1,250%	1,250%
Below CCC-	1,250%	1,250%	1,250%	1,250%	1,250%	1,250%

**Bjorn Bjerke**

Shearman & Sterling LLP  
599 Lexington Avenue  
New York, NY 10022  
USA

Tel: +1 212 848 4607  
Fax: +1 646 848 4607  
Email: [bjorn.bjerke@shearman.com](mailto:bjorn.bjerke@shearman.com)  
URL: [www.shearman.com](http://www.shearman.com)

Bjorn Bjerke is a partner in the Finance Group and resident in the New York office. He focuses his practice on representing borrowers, lenders, managers and investors in a broad range of complex financing and derivatives arrangements across a wide spectrum of asset classes including securitisations and other structured financings, various shared collateral and second lien structures, repo facilities, commodity, equity, credit and fund linked derivatives and a variety of hybrid capital and non-recourse asset-based financings. In addition, he has extensive experience representing investors, creditors and managers in complex restructurings, work-outs and acquisitions of distressed and non-performing assets. He is involved in all aspects of deal structuring, negotiation and documentation.

Bjorn's full professional profile is available at:  
<http://www.shearman.com/en/people/b/bjerke-bjorn>.

**Azad Ali**

Shearman & Sterling LLP  
Broadgate West, 9 Appold Street  
London, EC2A 2AP  
United Kingdom

Tel: +44 20 7655 5659  
Fax: +44 20 7655 5237  
Email: [azad.ali@shearman.com](mailto:azad.ali@shearman.com)  
URL: [www.shearman.com](http://www.shearman.com)

Azad Ali is counsel in the firm's global Financial Institutions Advisory & Financial Regulatory Group based in the firm's London office. He advises financial institutions on legal and regulatory aspects of their businesses and transactions in London and the continental European markets on a wide range of UK and EU regulatory matters including on bank regulatory issues, bank structural reform, OTC derivatives regulations and conduct regulation. Mr. Ali also advises on the implementation and impact of the EU/UK regulatory reforms, such as Basel III, CRD IV, EMIR and AIFMD as well as other global regulatory developments that arose out of the recent financial crisis. Mr. Ali also has experience representing originators and underwriters in securitisations, CDOs and repackagings.

Mr. Ali is listed in the Legal 500, Who's Who in Law and recommended by the Legal 500, 2012.

Azad's full professional profile is available at:  
<http://www.shearman.com/en/people/a/ali-azad>.

## SHEARMAN & STERLING<sup>LLP</sup>

Shearman & Sterling's Structured Finance & Securitisation Group, with lawyers in New York, London, Washington, DC and Frankfurt, assists clients in developing, structuring and executing a broad range of complex financings involving securitisation, structured products and other sophisticated financing techniques. We have in-depth experience in all aspects of the public and private distribution of structured finance securities. Highly regarded by major corporations and financial institutions, we represent the entire range of global market participants, including issuers, underwriters, investors, trustees, servicers, credit enhancement providers, lenders, rating agencies and conduits.

We are adept at executing transactions in multiple jurisdictions in the U.S., Europe, Asia and Latin America, and have securitisation experience in all relevant disciplines, including capital markets, banking, investment company, tax, corporate, bankruptcy, investment advisors acts, ERISA, bank regulatory, securities regulation and secured financing.

# Time to Support High Quality Securitisation



Association for Financial Markets in Europe

Richard Hopkin

During the last twelve months, for the first time since the onset of the financial crisis, the tone of the regulatory response towards securitisation has become more encouraging as policymakers increasingly acknowledge the positive contribution that high quality securitisation can make in helping to restore growth in Europe.

Hope grew that these senior policymaker views would translate into positive regulatory signals that would bring ABS investors back to the marketplace.

Last year concluded with a flurry of updates of major regulatory initiatives: firstly, the Basel Committee recommendations on capital requirements for bank investors in ABS; secondly, a report from the European Banking Authority (EBA) on liquidity; and thirdly the much awaited report from the European Insurance and Occupational Pensions Authority (EIOPA) on calibration of capital requirements for ABS investment by insurance companies under Solvency 2.

The final form of these regulatory initiatives will have significant implications on whether Europe's securitisation market begins to recover or continues to languish at historically low issuance levels.

The Basel Committee re-proposal on ABS capital requirements is a significant improvement on the first proposal. A number of the industry's requests have been, at least, partly accommodated: the overall hierarchy of approaches is much simpler; some account is taken of excess spread; and the proposed floor on risk weights has been reduced from 20 to 15 per cent. However, the amounts of capital likely to be required even under the revised proposals remain significantly higher than at present, and than is justified by the historically strong credit performance of most securitisations.

The new Solvency 2 calibrations issued by EIOPA also represent a positive step forward by recognising, for the first time in a regulation, the concept of high quality securitisation. For insurers holding ABS, EIOPA has moved from a 7 per cent capital requirement per year of duration, to 4.3 per cent. However, even this reduced requirement remains very high – for a five-year AAA RMBS, 5 years x 4.3 per cent = 21.5 per cent of capital would need to be held by insurers. There is growing market concern that the reduction to 4.3 per cent is unlikely to be enough to encourage insurance investors back to the market, or even for those who remain to stay.

The EBA report on the liquidity coverage ratio takes a narrow approach, including only RMBS, subject to certain conditions, as a high quality liquid asset. AFME has consistently sought a broader approach, and we believe there is evidence to support the inclusion of other forms of high quality securitisation such as auto loans.

Whilst these initiatives show some positive steps forward, much remains in the balance. Securitisation issuance in Europe remains

depressed and significant threats remain to the revival of the securitisation market, both from existing and new regulatory proposals, and from overall monetary policy.

## New Issuance and Outstandings

New issuance remains very low. AFME's most recent data report available at <http://www.afme.eu/Divisions/Securitisation.aspx> shows that total issuance in Europe for 2013 was €181 billion, a fall of 28 per cent from 2012. Of this headline figure, only €76.4 billion – just over one-third – was placed with investors. The rest was retained by issuers and used for repo purposes with the ECB or national central banks.

For comparative purposes, the 2007 market saw €454 billion of issuance, nearly all of which was placed, so the market has shrunk by over 80 per cent over five years.

## Dealing with the Past

While a more balanced view of the benefits of securitisation is beginning to emerge, some outside the industry still perceive securitisation negatively. This is a mistake: the evidence continues to show that credit, liquidity and ratings performance of high quality European securitisations since the crisis has been very good.

To address this misperception, much work has already been done to restore the reputation of securitisation, both through market-led initiatives and new regulations – many of which are now in place. The Prime Collateralised Securities (PCS) label is fully established and has already built an impressive market share. The European DataWarehouse has been implemented and will, for the first time, make available loan-level data for all ECB-eligible securitisations in a single central database. The industry has adjusted well to the risk retention requirements of Article 405 of the Capital Requirements Regulation<sup>1</sup>, something made easier by the fact that nearly all European securitisations already retained “skin in the game” even before the financial crisis.

## A Change in Tone

Many high-level policymakers have recently made positive remarks about securitisation, and the need to restore the market, most recently President Draghi and Yves Mersch of the ECB and Andy Haldane of the Bank of England. In its March 2013 Green Paper “Long-Term Financing of the European Economy”, the European Commission acknowledged that “reshaping securitisation markets could also help unlock additional sources of long-term finance ...

and help financial institutions free capital, which can then be mobilized for additional lending”.

## Regulation Continues to Solve for the Last Crisis, Not the Next One

Unfortunately, despite these high-level statements of support and the cautious optimism brought about by recent regulatory developments, the reality of regulation on the ground remains one of heavy calibration, overly broad scope and a continuing focus on the past.

Many issues in existing regulations remain unresolved, such as the Basel, Solvency II and liquidity issues mentioned above.

In addition, important new regulations have emerged in recent months which, if not adjusted, will strongly discourage any revival of the securitisation market.

The most significant of these include the regulation for money market funds proposed in September 2013 by the European Commission, which bans money market funds from investing in securitisations other than those which fall within a narrow definition of “eligible securitisation”. Some in the European Parliament are proposing restrictions on tranching, so that no eligible securitisation can have more than three tranches – an idea that ignores the fact that tranching is a response to investor demand, not complexity for its own sake. Such restrictions would prohibit money market funds from investing in asset-backed securities and asset-backed commercial papers, reducing funding for corporates and the “real economy”.

The recent publication by ESMA of its consultation paper on draft Regulatory Technical Standards for additional disclosure for structured finance instruments also gives rise to concern, by extending existing disclosure requirements to private transactions and imposing a legal requirement for loan level data for all asset classes, however granular.

## Is the Cure Prolonging the Disease?

The deeply subdued volumes described above are partly caused by today’s highly unusual monetary conditions; it is difficult to make the argument that securitisation is cost-effective when much cheaper funding is plentifully available under various ECB and national central bank schemes. While from a macro-economic perspective the reasons for current monetary policy are understood, an unfortunate side-effect is that reduced deal flow is making it more and more difficult for investors to justify the infrastructure they need – experienced analysts, data and technology – to maintain a presence in the market.

## A Call for Action

Securitisation has a critical role to play in providing funding for growth. In an environment where banks are deleveraging, European businesses that traditionally relied on banks must now instead access the capital markets. It is time to stop punishing securitisation, and instead nurture and expand it to help ensure economic growth.

Securitisation has changed. New regulations mandate better alignment of risk, greater transparency, and less reliance on credit ratings. Market initiatives promote a focus on high quality.

2014 is shaping up to be a pivotal year. Much work remains to be done to ensure more co-ordinated, more sensibly-calibrated and evidence-based regulation that better reflects the performance of high quality European securitisation. Only then will securitisation be able to play its full role in funding Europe’s recovery from recession.

## Endnote

- 1 Formerly Article 122a of the Capital Requirements Directive.



**Richard Hopkin**

The Association for Financial Markets  
St. Michael's House, 1 George Yard  
London, EC3V 9DH  
United Kingdom

Tel: +44 207 743 9375  
Email: richard.hopkin@afme.eu  
URL: www.afme.eu

Richard Hopkin is Managing Director and Head of the Securitisation Division. He joined AFME in June 2010 after a 20-year career in European securitisation during which he held leadership positions at J.P. Morgan, Deutsche Bank and Société Générale.

He has originated, structured and distributed financings backed by a wide variety of asset classes including mortgages, credit cards, auto, consumer and SME loans, from across Europe, Australia and the US.

Born and brought up in Wales, Richard read law at Cambridge University and before embarking on his banking career he qualified as a solicitor with leading international law firm Clifford Chance.



The Association for Financial Markets in Europe advocates stable, competitive and sustainable European financial markets, which support economic growth and benefit society. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks, as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association through the GFMA (Global Financial Markets Association). For more information, please visit the AFME website, [www.afme.eu](http://www.afme.eu).

# Albania

Artan Hajdari



Adi Brovina



## Haxhia & Hajdari Attorneys At Law

### 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

(a) According to the Civil Code (art. 83/2), the legal action (contract) is invalid if it is not made in such form required by the law. In other cases the legal action (contract) is valid but cannot be proved by witnesses. This principle is applicable to all types of contracts, including sales contracts of movable and immovable properties. Alienation of movable and immovable items and the real rights must be notarised, otherwise the contract is not valid (*solo consensus*).

(b) The invoices released by the seller are not sufficient to prove the existence of the obligation (contract), in this case the consent of the party that has assumed the obligation (*obligor*) is also needed.

(c) The sale of goods and services should be made through the contract, without the need of their submission (the items). Specified items are excluded (measurable by number, weight or quantity) of which the submission is required to make possible the acquisition of the property. In sales contracts for goods and services (bilateral contract) it is specified by law that the parties are forced mutually against each other; therefore the behaviour of parties in a contract is one of condition for the existence of this contract (Civil Code art. 663).

**1.2 Consumer Protections. Do Albania’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

(a) The domestic law does not foresee any limitation in the defence of the consumer with the aim of restricting interest loans, granted loans or other contractual obligations. The rights and obligations of the parties are subject to contractual freedom and are bound by the market indicators.

(b) The domestic law does not foresee any legal rights for the protection of the consumer rights who are late in the payment of their obligations. Interests normally are accounted while what the law can forgive are the penalties in case of the payment of obligations and interest.

(c) The domestic law does not foresee any rule which allows the consumer not to pay the assumed long term obligations. Only the agreement between parties may allow this.

(d) The consumer is subject of liabilities undertaken in a contract and can be dismissed from them only by agreement with the other party (seller) and/or by a court decision in case of non-fulfilment of obligations by the seller.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

The same rule is applied as for the customer. The state agencies have determined accurately the criteria to be followed in the sale and execution process of receivables.

### 2 Choice of Law - Receivables Contracts

**2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Albania that will determine the governing law of the contract?**

The main principle recognised by Albanian legislation is that of contractual freedom of the parties in a contract. In case the parties are not able to qualify their relationship (the contract) in a provision of the law in force, then they can establish an atypical contract following the general principles on the law on contracts. Albanian law allows the contractual relationship stabilisation on the basis of typical and atypical contracts.

**2.2 Base Case. If the seller and the obligor are both resident in Albania, and the transactions giving rise to the receivables and the payment of the receivables take place in Albania, and the seller and the obligor choose the law of Albania to govern the receivables contract, is there any reason why a court in Albania would not give effect to their choice of law?**

The court has no legal reason to modify the will of the seller and the obligor relating to the applicable law and jurisdiction. According to procedural civil law the court is obliged to apply the will of the parties relating to these two criteria.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor.** If the seller is resident in Albania but the obligor is not, or if the obligor is resident in Albania but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Albania give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

The freedom to choose the foreign law of a non-resident seller or obligor is allowed under domestic law: art. 45 of law no. 10428 of 2 June 2011, the International Private Law. According to this article (freedom to choose the applicable law) the contract can be governed by the law chosen by the parties. This means there is no limitation to the recognition of foreign law which typically applies in commercial relations such as between the seller and the obligor under a receivables contract.

**2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Albania?**

Yes, it is.

### 3 Choice of Law - Receivables Purchase Agreement

**3.1 Base Case.** Does Albanian law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Albania's laws or foreign laws)?

Albanian law does not require that the sale of receivables be governed by the same law as the law governing the receivables themselves. The governing law, in the absence of a clear choice of law by the parties, is determined according to the principles explained in question 2.1. Albanian law admits that the applicable law governs issues related to the transferability of receivables, the relations between the purchaser or the seller and the obligor, conditions concerning the opposability of the sale of receivables against the obligor and the discharge from liability of the obligor.

**3.2 Example 1:** If (a) the seller and the obligor are located in Albania, (b) the receivable is governed by the law of Albania, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Albania to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Albania, will a court in Albania recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

If Albanian law governs the receivables purchase agreement, and if the sale complies with the requirements of Albanian law, the location of the purchaser is irrelevant to Albanian courts with regard to the effects of the sale against the seller, the obligor and other third parties. However, the purchaser (in factoring agreements) shall comply with the rules of the third country where he is established with regard to necessary authorisations and criteria permitting the exercise of such activity.

**3.3 Example 2:** Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Albania, will a court in Albania recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

It is not necessary to comply with the requirements of foreign laws if Albanian law is applicable.

**3.4 Example 3:** If (a) the seller is located in Albania but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Albania recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Albania's own sale requirements?

Yes, it will. However, these issues are not very common before Albanian courts and it would be advisable, with regard to third parties who may oppose the sale, to comply with registration obligations in Albania.

**3.5 Example 4:** If (a) the obligor is located in Albania but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Albania recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Albania's own sale requirements?

The sale will be effective against the obligor. However, the sale shall not be contrary to the principles of *ordre public* and shall not concern, for instance, receivables resulting from transactions for personal or domestic use of the obligor or unseizable receivables in general.

**3.6 Example 5:** If (a) the seller is located in Albania (irrespective of the obligor's location), (b) the receivable is governed by the law of Albania, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Albania recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Albania and any third party creditor or insolvency administrator of any such obligor)?

The sale would be effective against the seller. However, with regard to third parties, please refer to our answer to question 3.4.



## 4 Asset Sales

### 4.1 Sale Methods Generally. In Albania what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

The Albanian Civil Code (ACC) (arts. 499 *et seq.*) provides a general method for the creditor (seller) to transfer his claims against an obligor to a third party (purchaser). The transfer is operated through a transfer contract signed between the creditor (seller) and the third person. A more complex method consists of a factoring agreement (law no. 9630 dated 30 October 2006) through which a supplier (seller) transfers receivables to a factor (purchaser) in exchange of a pre-determined sum or interest rate.

The law usually refers to these transactions as “sale” or “transfer”.

### 4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

The contract shall be in written form and the consent of the obligor is not required. The sale of receivables organised by the ACC requires a notification to the obligor in order for the transfer to be effective. The notification to the obligor or the acceptance of the transfer from this party is the starting point and the sufficient formality needed for the contract to be opposable to third parties.

With regard to factoring agreements, the sale shall be notified to the obligor and shall be published in a special register (mortgage registry) in order to be opposable to third parties.

When the receivable is transferred to subsequent good faith purchasers the first one to notify the obligor is the preferred purchaser. In factoring agreements, subsequent contracts are deemed not valid and may constitute a criminal offence.

### 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

The same requirements and registration have to be met by parties in transactions concerning promissory notes, mortgage loans, consumer loans or marketable debt securities.

### 4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

Please refer to our answer to question 4.2. When the receivables

contract expressly prohibits assignment, the obligor is not bound by the transfer if he proves that the purchaser knew the existence of the prohibition (art. 499 ACC). However, receivables guaranteed by a possessory pledge are transferred with no guarantee, unless the obligor agrees that the possessory pledge is transferred to the purchaser. In factoring agreements, prohibition clauses provided in receivables' contracts are not effective. Notification to the obligor is important also with respect to the purchaser who is obliged to pay the seller in case the obligor, for any reason, pays him instead of the seller (art. 14.3 of law no. 9630 dated 30 October 2006).

The obligor is entitled to invoke against the factor any rights and defences (including set-off) that he had against the supplier (seller) prior to notification.

### 4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

The notice shall be delivered in any particular form. However, in factoring agreements the notice shall be made in written form and shall be delivered by the supplier (seller) or by the factor (containing the seller's authorisation). The notice shall determine as exactly as possible the receivables and, while the factoring agreement is valid also for future receivables, the notice on the contrary is valid only for receivables already existing.

### 4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that “None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]” be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says “This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]” (i.e., the restriction does not refer to rights or obligations)?

Please refer to our answer to question 4.4. The clauses will most probably be interpreted as identical by Albanian courts. However, the different clauses will not have any incidence on the perfection of the sale of receivables, if the interested party does not prove that the purchaser knew the existence of such limitations.

### 4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Albania? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Albania recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

The restriction is enforceable only in case the plaintiff proves that the purchaser knew the existence of the limitation. In this case, the

receivables sale may be annulled by the court and the seller and/or purchaser may be liable towards the obligor for breach of contract (seller) or extra contractual liability (purchaser). In factoring agreements, such restriction is not opposable to the factor (purchaser).

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

Art. 507 of the ACC provides that the sale of receivables shall be accompanied by all documents related to them. Art. 3.4 of the law on factoring does not request that the receivables be individually identified. Notification to the obligor includes the identity of the factor (purchaser) and identification (in as much detail as it is possible), of the receivables to be sold.

Receivables may have different characteristics as long as they can be identified by the contract. All receivables, existing or future, may be sold through a unique sale agreement. However, future receivables may be transferred only if they arise out of contracts signed within 24 months starting from the signature date of the factoring agreement.

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

A court is not bound by the name parties give to their contracts and may enquire the economic characteristics of a contract in order to apply the relevant rules of law. Parties shall determine the sum to be paid and/or an interest rate. On the contrary, the contract may not be interpreted as a sale. The factor is obliged to perform only two of the following actions: a) pay the supplier (seller), including pre-payments; b) keep the books and data of receivables; c) control of collections of receivables; and/or d) guarantee the seller from the insolvency of the obligor. A combination of two of these actions shall be sufficient for the perfection of the sale of receivables.

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

Yes. Provisions of the factoring agreement are applied automatically as soon as receivables exist. Please refer to our answer to question 4.8.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?**

Yes, the signature of only one contract is sufficient for the transfer of future receivables that may be identified. However, a new notice shall be given to the obligor when the receivables begin to exist. The sale of future receivables shall determine as exactly as possible the characteristics of future receivables in order to be identifiable. Please refer to our answer to question 4.8.

There exists no unified court decision with regard to the combination of the coming into existence of future receivables and insolvency. The law on factoring provides that receivables may be transferred even before contracts from which they arise from, are signed. Nevertheless, insolvency law has a special status and, for instance, the administrator of insolvency has the right to terminate ongoing contracts.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

With the exception of the possessory pledge, security related to receivables is transferred to the purchaser who shall, accordingly, perform the necessary registrations.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

The obligor's set-off rights terminate at the moment he receives notice of the transfer; he may set-off against amounts he owes to the seller up to the moment of the delivery of notification. The law does not provide any liability for damages caused by such termination.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Albania to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

The factor and the supplier can predict the means for securing the contract factoring transactions. Assets include deposit insurance, insurance burden, pledges or other security, in accordance with the legal provisions in force. The factoring law provides for both recourse and non-resource factoring with security and without security.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Albania, and for such security interest to be perfected?**

The formalities associated with sellers' security in the case of "Back-up security" in order that the guarantee can be called perfect in terms of law, for example a guarantee on an immovable property, should be done in an affidavit form and/or it should be registered near the real estate office. In cases where the guarantee is a title or a loan, this guarantee should be registered near the office of Insurance Burden Register, which is the unique institution in the Republic of Albania.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Albania to grant and perfect a security interest in purchased receivables governed by the laws of Albania and the related security?**

In this case, the buyer, must perform the act in accordance with the law which established the guarantee and he should release a written guarantee to secure that the assets are not owned by him or given in favour of another person.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Albania, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Albania or must additional steps be taken in Albania?**

In connection with this issue, our legislation is considered applicable to all these arrangements if they are part of the applicable provisions of law chosen by agreement between the parties.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

According to our legislation, no additional or different requirements apply to security interests in, or connected to, insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities.

**5.6 Trusts. Does Albania recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

A trust agreement is not a category of agreement specifically provided for under Albanian legislation. They can be created only by special agreement of the parties, however, there is no society in Albania to exercise genuine activity of a company trust.

**5.7 Bank Accounts. Does Albania recognise escrow accounts? Can security be taken over a bank account located in Albania? If so, what is the typical method? Would courts in Albania recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Albania?**

Yes. Cash collateral is the typical method. However, the Bank of Albania has not developed any regulations for this type of bank activity. Such an agreement can be adjusted only by contract based on the Civil Code, but this contract must first be subjected to a prior approval from the Bank of Albania.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

With regard to the security over a bank account, the secured party does not control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full. Albanian legislation has limitations. According to art. 605 of the Civil Code of Albania, it is preferably paid according to their rankings with the following loans:

- a) loans arising from financial transactions collateralised insurance for the purchase price of a particular object;
- b) loans arising from wages to labour relations or obligations for service and food, but for no more than 12 months;
- c) social security credits for unpaid contributions together with interest, and loans to employees for losses suffered by the grace of employer contributions above;
- d) loan rewards stemming from death, or injury to health;
- e) loans to the persons taking the loan and their heirs for bonuses derived from the alienation of the whole, or part, of their rights in the intellectual field for obligations incurred during the last two years;
- f) state loans arising from obligations to the budget and loans to a state insurance institute for mandatory insurance, stipulated by law;
- g) loans arising from financial transactions' collateralised insurance, according to criteria established by law;
- h) loans arising from wages to labour relations or obligations for food services and further limits specified under b) above;
- i) the remuneration of mediation stems from the agency contract, when it flows over the last year of the remuneration;
- j) loans secured by mortgage or mortgage insurance that does not create a burden under the law, the value of the items pledged or mortgaged;
- k) loans arising from court costs for maintaining the property and executive actions, made in the common interest of the creditors, by value of the sale of the items;
- l) loans granted by banks, which are not included under e) and credits resulting from voluntary insurance; and
- m) loans for the supply of seeds, fertilisers, insecticides, water for irrigation and cultivation works collection of agricultural products, products (fruits) of the agricultural year, which are used for loans.

When there is some credit under a) and e), the line of preference is defined according to the criteria established by special law. When the special law does not give a loan in a) preference on loans under

e), the credit under a) will be preferred to that under e). Excluded from the order of preference under this section are credits under e), which are currently provided and will be preferred ahead of credit under f) in the following cases:

- credit under e) is registered under the law, while credit under f) is not registered; and
- credit under e) is registered under the law, before the registration of credit under f).

---

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

---

The owner cannot have access without affecting the security.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Albania's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

In accordance with art. 100 of law no. 8901 dated 23 May 2002 "On Insolvency" updated by law no. 10137 dated 11 May 2009, no automatic stay is applicable.

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

In accordance with art. 100 of law no. 8901 dated 23 May 2002 "On Insolvency" updated by law no. 10137 dated 11 May 2009:

- 1) The insolvency administrator may challenge the actions performed before opening bankruptcy proceedings, and that harm creditors' bankruptcy, under arts. 101 through 115 of this law.
- 2) In the case provided for in paragraph 1, inaction is considered equivalent to action.

According to art. 101, any action that guarantees a bankruptcy administrator tool or repayment insurance can be challenged if:

- a) the action is performed within 90 days preceding the application for opening insolvency proceedings if the debtor, at the time the action was taken, was in a state of insolvency and the creditor at this time was aware of this; and
- b) the action is performed after the request for the opening of bankruptcy proceedings and if the creditor was aware of the debtor's insolvency at the time of the action or demand for the opening of bankruptcy proceedings.

Knowledge about the circumstances that led directly into insolvency or to a request for opening bankruptcy proceedings is treated in the same way as knowledge of insolvency or knowledge of the application for the opening of bankruptcy proceedings.

A person who has close connections with the debtor at the time this action under section 107 of this law is undertaken, is presumed to have had knowledge of the insolvency or of the request to open bankruptcy proceedings.

Pursuant to art. 102, any action that guarantees a bankruptcy administrator tool or repayment insurance, or the vehicle which allows security benefit or repayment without having the right tool for insurance or repayment, may be challenged if the action is done:

- a) during the last month, before the request for the opening of bankruptcy proceedings or after submission of this application in the commercial section of the district court;
- b) by the end of the second or third month before the request for the opening of bankruptcy proceedings and if the debtor was insolvent at the date of the action; or
- c) by the end of the second or third month, before the request for the opening of bankruptcy proceedings and if the debtor was aware that the execution of such act would damage the insolvency creditors.

Albanian legislation recognises the possibility of invalidation of the actions entered into between the debtor and any third party when under the first paragraph mentioned above it is revealed that such actions of the debtor have directly damaged the interest of the bankruptcy creditors.

Each agreement providing payments obligations entered between a debtor and any of his relatives that directly harm the interest of the bankruptcy creditors can be challenged under the condition settled by art. 107 of the Law on Bankruptcy. These agreements cannot be challenged if they are stipulated two years before the opening of bankruptcy procedures or when the third party was not aware at the same moment of entering into the said agreement for the intention of the debtor to harm the interest of the creditors.

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Albania for (a) transactions between unrelated parties, and (b) transactions between related parties?**

Please see the answer to question 6.2 above.

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

Please see the answer to question 6.2 above.

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Albania, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

Please see the answer to question 6.2 above.

**6.6 Effect of Limited Recourse Provisions.** If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?

No. The debtor cannot raise such a claim.

## 7 Special Rules

**7.1 Securitisation Law.** Is there a special securitisation law (and/or special provisions in other laws) in Albania establishing a legal framework for securitisation transactions? If so, what are the basics?

The Securing Charges are governed by law no. 8537 dated 18 October 1999 "On Securing Charges" on some amendments of the law no. 9524 dated 25 April 2006. The Albanian parliament approved law no. 132/2013 ("Law 132/2013") which amends law no. 8537 dated 18 October 1999 "On Securing Charges". According to the amendment, references to "intangible properties", "securities", "instruments" and "accounts" in the Law "On Securing Charges" are abrogated.

Intangible properties, securities, instruments and accounts as they were defined in the Law "On Securing Charges" shall no longer be granted as collateral under such law. Due to this amendment, securing charges can be taken only over tangible movable assets.

This law governs any transaction, whatever its form and however it is denominated, that creates, whether by transfer of ownership, by possession such as in the case of a pledge or otherwise, a securing charge in movable things, or rights of their owner. The rules applicable to securing agreements apply in the same way to the following transactions, which for the purpose of this law are considered securing agreements:

- a) a contract for the sale of goods providing for reservation of title of the sold goods until payment of the purchase price and the fulfilment of any other obligation;
- b) a transaction involving the sale of an account;
- c) a transaction, called a consignment, involving the transfer of possession of goods from the owner;
- d) to another person for the purpose of sale by that person; and
- e) a lease of goods having a term of more than one year.

**Art. 4 of the law determines that the provisions of this law does not apply to:**

- a. a transfer of a claim for compensation of an employee;
- b. a sale of accounts as part of a sale of the business out of which they derive;
- c. a transfer of a right to payment under a contract to a transferee that is also obliged to perform under the contract;
- d. a transfer of a right to payment under an hypothec on immovable property or payments made under a lease of immovable property;
- e. a transfer of accounts made solely to facilitate the collection of accounts for the transferor;
- f. a financial collateral agreements, regulated by special law;
- g. a transfer of a right represented by a judgment, other than a judgment taken on a right to payment that was collateral; or
- h. a transaction governed by another law of Albania including an international convention or treaty that governs the creation, completion, priority, or enforcement of a securing charge created by Albania or a political unit of Albania.

**7.2 Securitisation Entities.** Does Albania have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

The law does not provide for the establishment of securitisation entities.

**7.3 Limited-Recourse Clause.** Will a court in Albania give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

Please see the answer to question 7.4 below.

**7.4 Non-Petition Clause.** Will a court in Albania give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

According to art. 686 of the Albanian Civil Code, a non-petition clause should be considered valid in case that is approved by the party through a different act.

**7.5 Priority of Payments "Waterfall".** Will a court in Albania give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

There is no rule by any special law. If the parties agree, they can create a contractual relationship and it is not prohibited by law.

**7.6 Independent Director.** Will a court in Albania give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

This is not applicable.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc.** Assuming that the purchaser does no other business in Albania, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Albania? Does the answer to the preceding question change if the purchaser does business with other sellers in Albania?

Only registration with the Albanian Commercial Register and with the tax authorities is required.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

Servicing and administration of the assigned receivables does not require the need to obtain a local licence.

In general, the assistance of a lawyer is required to appear in courts.

**8.3 Data Protection. Does Albania have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

Data protection in Albania is governed by law no. 9887 dated 10 March 2008, as amended by law no. 48/2012 “On Personal Data Protection”.

According to art. 3 of the Law On Personal Data Protection, “personal data” shall mean any information relating to an identified or identifiable natural person, directly or indirectly, in particular by reference to an identification number or to one or more factors specific to his physical, physiological, mental, economic, cultural or social identity. Art. 6 provides legal criteria for processing, on the basis of which, the personal data may be processed only if:

- a) *the personal data subject has given his consent; and*
- b) *processing is necessary for the performance of a contract to which the data subject is a party or in order to negotiate or amend a draft/contract at the request of the data subject.*

In other terms, data about, or provided by, obligors may be processed or disseminated by other parties in the contract as long as it is necessary for the conclusion of the said agreement.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Albania? Briefly, what is required?**

The protection of consumers is governed by law no. 9902, dated 17 April 2008 “On the Protection of Consumers”.

1. A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties’ rights and obligations arising under the contract, to the detriment of the consumer.

2. A term shall always be regarded as not individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term, particularly in the context of a pre-formulated standard contract.

The fact that certain aspects of a term or one specific term have been individually negotiated shall not exclude the application of this article to the rest of a contract if an overall assessment of the contract indicates that it is nevertheless a pre-formulated standard contract.

Where any seller or supplier claims that a standard term has been individually negotiated, the burden of proof in this respect shall be incumbent on him.

3. The unfairness of a contractual term shall be assessed, taking into account:

- a) the nature of the goods or services for which the contract was concluded;
- b) the time of conclusion of the contract;

- c) all the circumstances attending the conclusion of the contract; and
- d) all the other terms of the contract or of another contract on which it is dependent.

4. The terms which may be regarded as unfair:

- a) excluding or limiting the legal liability of a seller or supplier in the event of the death of a consumer or personal injury to the latter resulting from an act or omission of that seller or supplier;
- b) inappropriately excluding or limiting the legal rights of the consumer *vis-à-vis* the seller or supplier or another party in the event of total or partial non-performance or inadequate performance by the seller or supplier of any of the contractual obligations, including the option of offsetting a debt owed to the seller or supplier against any claim which the consumer may have against him;
- c) making an agreement binding on the consumer whereas provision of services by the seller or supplier is subject to a condition whose realisation depends on his own will alone;
- d) permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract;
- e) requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation;
- f) authorising the seller or supplier to dissolve the contract on a discretionary basis where the same facility is not granted to the consumer, or permitting the seller or supplier to retain the sums paid for services not yet supplied by him where it is the seller or supplier himself who dissolves the contract;
- g) enabling the seller or supplier to terminate a contract of indeterminate duration without reasonable notice except where there are serious grounds for doing so;
- h) automatically extending a contract of fixed duration where the consumer does not indicate otherwise, when the deadline fixed for the consumer to express this desire not to extend the contract is unreasonably early;
- i) irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract;
- j) enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract;
- k) enabling the seller or supplier to alter unilaterally without a valid reason any characteristics of the product or service to be provided;
- l) providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was concluded;
- m) giving the seller or supplier the right to determine whether the goods or services supplied are in conformity with the contract, or giving him the exclusive right to interpret any term of the contract;
- n) limiting the seller’s or supplier’s obligation to respect commitments undertaken by his agents or making his commitments subject to compliance with a particular formality;
- o) obliging the consumer to fulfil all his obligations where the seller or supplier does not perform his;
- p) giving the seller or supplier the possibility of transferring his rights and obligations under the contract, where this may

serve to reduce the guarantees for the consumer, without the latter's agreement; and

- q) excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions, unduly restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract.

#### 8.5 Currency Restrictions. Does Albania have laws restricting the exchange of Albania's currency for other currencies or the making of payments in Albania's currency to persons outside the country?

No, Albania does not have restrictions.

## 9 Taxation

#### 9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Albania? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?

The payments performed by the obligators to the seller or the purchaser shall not be subject to withholding tax, if all the parties are Albanian tax payers. According to Albanian legislation, those not registered as tax payers or foreigners that are not tax resident in Albania are subject to withholding tax. As above, any payment made to a foreign subject shall be subject to the withholding tax. Furthermore, the regulation on payment of withholding tax by the foreign subject will depend on the Agreements on Avoidance of double taxation that might exist between Albania and the country where the subject has its registered office.

Withholding tax in Albania at the rate of 10 per cent is payable on the incomes generated by:

- dividends;
- profit distribution;
- interest;
- copyrights and royalty payments;
- payments on technical, management, financial and insurance services;
- payments on construction, installations, assembly or other related supervisory work;
- rental payments;
- payment for performance of actors, musicians, or athletes, including payments made to subject hiring artists or athletes or managing on their behalf the participation in activities; and
- incomes of individuals deriving from gambling.

#### 9.2 Seller Tax Accounting. Does Albania require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

The national accounting standard applicable in Albania does not provide any specific accounting policies *in lieu* of securitisation. Albanian entities operating as small and medium-size enterprises apply the national accounting standards. However, large companies, affiliates of international ones or other companies might chose to apply the International Accounting Standard.

#### 9.3 Stamp Duty, etc. Does Albania impose stamp duty or other documentary taxes on sales of receivables?

The sale of receivables is exempt from any stamp or duty or other documentary impositions. If the agreement on sale of receivable is a notary deed then a notary fee shall be payable. The notary varies on the value of the relative agreement.

#### 9.4 Value Added Taxes. Does Albania impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

VAT is applicable on sales of goods and those services specified by law and on fees of collections. Furthermore, the Albanian fiscal legislation provides that financial services, including sales of receivables under factoring are VAT-exempt.

#### 9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

The purchaser shall not be held liable for the liability of the seller on VAT or other duties and imposes such taxes, duties and impositions that are applicable in a sale of a receivable.

#### 9.6 Doing Business. Assuming that the purchaser conducts no other business in Albania, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Albania?

In general, according to Albanian legislation, the entities that are required to have a permanent establishment are those who are subject to VAT – please refer to question 9.4 above. The purchaser who may be subject to withholding tax as explained in question 9.1 above, is not the subject of taxation in the country, as the tax obligation remains registered in Albania with the taxpayer, who will deduct any tax to be applied to a foreigner from the amount due.

**Artan Hajdari**

Haxhia & Hajdari Attorneys At Law  
Blvd. Deshmoret e Kombit  
Twin Towers, Tower 2, 9th Floor  
Tirana  
Albania

Tel: +355 4 22 80 170  
Fax: +355 4 22 80 171  
Email: [artanhajdari@lawfirmh-h.com.al](mailto:artanhajdari@lawfirmh-h.com.al)  
URL: [www.lawfirmh-h.com.al](http://www.lawfirmh-h.com.al)

Mr. Hajdari started practising law in 1991 and was admitted to the ABA (Albanian Bar Association) in 1998. He has a degree in Law from the Faculty of Law, University of Tirana. Mr. Hajdari also accomplished his Masters Degree on European Studies, in 2005. For many years he acted as a judge and held the position of the President of the District Court and Court of Appeal in Tirana. In 1993, Mr. Hajdari was the head of Vlora Court of Appeal. For two consecutive years Mr. Hajdari acted as deputy minister in the Ministry of Justice. He has contributed as a member in several working groups set up by various state and international structures with the aim of improving our legislation so that it is in line with the European Community. Currently, he is a lecturer in the Albanian School of Magistrates, and the author of several publications.

Mr. Hajdari speaks Albanian, English and Italian.

**Adi Brovina**

Haxhia & Hajdari Attorneys At Law  
Blvd. Deshmoret e Kombit  
Twin Towers, Tower 2, 9th Floor  
Tirana  
Albania

Tel: +355 4 22 80 170  
Fax: +355 4 22 80 171  
Email: [adibrovina@lawfirmh-h.com.al](mailto:adibrovina@lawfirmh-h.com.al)  
URL: [www.lawfirmh-h.com.al](http://www.lawfirmh-h.com.al)

Mr. Brovina was called to the Albanian Bar Association in 2012. He graduated in Law at Jean Moulin Lyon III University where he successfully completed a Masters degree (first and second class pass) in Advanced Corporate law (2008), a Masters degree of the first level in European law (2009) and is currently undergoing doctoral studies. He has completed a traineeship at the European Court of Human Rights. The law areas where he is focused are commercial and contract law.

Mr. Brovina speaks Albanian, English, French and Italian.



Founded in 1992, by Prof. Dr. Av. Maksim Haxhia, Haxhia & Hajdari Attorneys at Law is one of the premier and well-known law firms in Tirana, Albania offering a full range of services. The firm was founded straight after the fall of the dictatorship, when in Albania, there began a new era of a free trade market.

Haxhia & Hajdari Attorneys at Law has been a constant factor in the Albanian legal market and this is reflected in our numerous clients whom we have advised for years.

Haxhia & Hajdari Attorneys at Law has earned its reputation by being at the heart of the most complex commercial and financial transactions in Albania's jurisdiction.

Working with a very large range of clients from individuals to companies, we pride ourselves in earning confidence and trust as a result of our ability to understand our clients' needs.

*Pro bono* legal service is fundamental to our law firm, our lawyers and staff provide the highest quality legal services to all of our clients, billable and non-billable alike. *Pro bono* work at Haxhia & Hajdari Attorneys at Law not only satisfies our ethical obligation to help those in need, but is part of what makes our lawyers strong leaders in our practices.



# Argentina



Damián F. Beccar Varela



Roberto A. Fortunati

## Estudio Beccar Varela

### 1 Receivables Contracts

- 1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

In general, it is not necessary for the sale of goods and services to be enforceable, that they be instrumented under a specific form required by law. In Argentine law, the principle of freedom of forms governs. However, contracts above a certain value have to be evidenced in writing. Additionally, certain goods exist whose sale must be evidenced by certain formalities. Invoices can constitute evidence of a contract. It is also possible to infer the existence of a contract based upon a historic relationship between determined parties. For such purposes, invoices constitute one of the relevant elements for determining the presence of a contractual relationship.

- 1.2 Consumer Protections. Do Argentina’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

Except for certain operations (e.g., credits deriving from the use of credit cards), Argentine laws do not fix limits to the interest rates agreed upon by the parties to a contract. Certain court rulings have admitted that grossly out of market interest rates were usurious, and reduced them *ex-officio*. Argentine legislation envisages the right of all creditors to claim indemnification due to late payment; in particular, in the case of obligations to deliver sums of money, the indemnification owed by the defaulting debtor is the payment of interest.

- 1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

In principle, the contracts used for such purposes will be those existing under private law but formalities required by specific rules of administrative law may exist. Likewise, the enforcement of

contracts may be conditioned to compliance with certain prior requirements.

### 2 Choice of Law - Receivables Contracts

- 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Argentina that will determine the governing law of the contract?**

The governing law applicable to an international receivables contract will be determined, in a first analysis, by the applicable international treaty. If there is no international treaty applicable, the Argentine Civil Code will apply by default.

In general terms, the conflict of law principle applicable to an international commercial contract is the freedom of the parties to elect the applicable law. In case the parties do not elect an applicable law, the Argentine Civil Code establishes the following principles: (i) the governing law to a contract shall be the law of the place of performance of the contract’s principal (characteristic) obligation (Sections 1,209 and 1,210) (usually determined as the physical place of performance or as the domicile of the debtor of the characteristic obligation); and (ii) applicable laws to a contract shall be those of the place of execution of said contract (Section 1,205).

The foregoing general principles vary if the receivables are in connection with the sale of (i) movable assets (personal property) with a permanent situation in Argentina, with no intent of being transported abroad (Section 11), and (ii) real estate located in Argentina (Section 10). In both these cases, the contract shall be governed by Argentine law, notwithstanding the place of performance or execution of the contract.

Please consider that Argentina’s conflict of law principles are not contained in one single source, but spread in different regulatory bodies (e.g., the Civil Code, the Corporations Act, and Bankruptcy Act, among other laws).

- 2.2 Base Case. If the seller and the obligor are both resident in Argentina, and the transactions giving rise to the receivables and the payment of the receivables take place in Argentina, and the seller and the obligor choose the law of Argentina to govern the receivables contract, is there any reason why a court in Argentina would not give effect to their choice of law?**

No, there is not.

- 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor.** If the seller is resident in Argentina but the obligor is not, or if the obligor is resident in Argentina but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Argentina give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Notwithstanding the provisions established in Sections 10 and 11 of the Civil Code (that exclusively determine the application of Argentine law), in contractual matters, the seller and the obligor are free to choose the law which will govern the receivables, provided there is a reasonable connection between the parties or the receivables contract and the chosen law. For instance, such connection may arise from the place of execution of the contract, one or both parties' domiciles, the place in which the obligations from the contract are to be performed, among other connections.

As regards the Argentine courts' recognition of choices of law, there are some principles under Argentine law that operate as limitations to the application and recognition of foreign law:

(i) Argentine international public policy: The Argentine international public policy's limitation is not a fixed set of rules which the foreign law must comply with, but certain core principles which the foreign law must not violate. The analysis under the public policy limitation's standpoint is applied on a *a posteriori* basis; this is to say, after the analysis of the case, the principles and the solution granted by the foreign law, finally admitting or otherwise excluding the application of said foreign law. In this sense, Section 14.2 of the Argentine Civil Code provides that foreign law shall not be applicable when it is incompatible with the spirit of Argentine Civil Code.

It is important to mention that there are not many case law precedents where judges ruled that certain foreign laws violated Argentina's public policy, and even fewer precedents where said violations were determined due to the choice of law in a commercial contract.

(ii) "Immediate Application Norms": Notwithstanding the foregoing, there is also a tendency to acknowledge certain principles that operate *a priori* and are thus inflexible rules which are applicable despite the election of a foreign law by the parties. These rules are applicable even if the parties have chosen a different law to govern the contract. Bear in mind that these *a priori* norms are only applicable to certain specific cases, such as to corporations incorporated abroad that carry out their main business activities in the country (Section 124 of the Corporations Act).

#### **2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Argentina?**

The United Nations Convention on Contracts for the International Sale of Goods and the Protocol to Amend the Convention on the Limitation Period in the International Sale of Goods, both signed in Vienna on 11 April 1980, were ratified by Argentina on 19 July 1983 through Law 22,765. These rules became effective on 1 January 1988.

### **3 Choice of Law - Receivables Purchase Agreement**

- 3.1 Base Case.** Does Argentinian law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Argentina's laws or foreign laws)?

There is no specific rule, thus there is freedom to agree on the applicable law to both the sale of receivables and the receivables themselves.

- 3.2 Example 1:** If (a) the seller and the obligor are located in Argentina, (b) the receivable is governed by the law of Argentina, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Argentina to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Argentina, will a court in Argentina recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

The debtor's domicile is one of the usual connections used by the Argentine conflict of law rules. Therefore, if the seller's domicile is in Argentina and the domicile of the obligor is also in Argentina, an Argentine court would probably consider that the choice of the law of the country of the seller's domicile is a reasonable connection for these kinds of commercial relationships. Thus, the sale would be deemed effective against the seller (subject to some formalities detailed in question 4.2) and, in general terms, against any other creditor.

As regards the position of creditors or insolvency administrators in case a bankruptcy or insolvency proceeding is filed in Argentina, Bankruptcy Law provisions should be considered as well as other international treaties that may be applicable, as the case may be. In that sense, even if bankruptcy and insolvency rules do not interfere with the choice of law provisions themselves, the enforceability of the sale or receivables contract within a bankruptcy or insolvency proceeding could eventually depend on certain bankruptcy and insolvency proceedings' specific rules, such as the verification and acceptance (or not) of the credit and the violation (or not) of 3rd parties' rights (i.e., fraudulent bankruptcy, acts or agreements executed by the debtor during a period prior to commencement of proceedings in fraud of other creditors, among others).

In relation to the verification and acceptance of a foreign credit within a bankruptcy or insolvency proceeding initiated in Argentina, please take into consideration that Section 4 of the Bankruptcy Law sets forth that foreign creditors shall only be allowed to present themselves in the bankruptcy proceedings in Argentina and file a claim for their outstanding credit – that is payable abroad – before the Argentinian judge, only if the laws of the country of said foreign creditor would likewise allow an Argentine creditor to file a claim for his/her outstanding credit – payable in Argentina – in any bankruptcy proceedings in said foreign country). Of course, other requirements shall also be complied with under the Bankruptcy Law or international treaties, as the case may be.

**3.3 Example 2:** Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Argentina, will a court in Argentina recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

Please see the answer to question 3.2.

**3.4 Example 3:** If (a) the seller is located in Argentina but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Argentina recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Argentina's own sale requirements?

Under Argentine conflict of law rules, the seller, the obligor and the purchaser are free to choose the law which will govern their commercial relationship, provided there is a reasonable connection between the case and the chosen law. If the Argentine court determines that the election is valid under Argentine law and the sale has been legally executed under the applicable foreign law, an Argentine court would probably recognise the sale as being effective against the seller and other parties. This is to say, as long as Argentina's international public policy is not violated, the validity of the sale would be analysed only under the applicable foreign law in spite of any Argentinian specific sale requirements.

In case of bankruptcy, please note that law provisions regarding rights of foreign creditors and reciprocity should be taken into account (please see our answer to question 3.2).

**3.5 Example 4:** If (a) the obligor is located in Argentina but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Argentina recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Argentina's own sale requirements?

If the applicable foreign law was validly chosen, as mentioned in the answer to the previous question, and provided that Argentina's international public policy was not violated, an Argentine court will recognise that sale as being effective against the obligor.

Bankruptcy Law provisions regarding the rights of creditors and reciprocity in case of bankruptcy proceedings opened in Argentina with foreign creditors should be considered (please see our answer to question 3.2).

**3.6 Example 5:** If (a) the seller is located in Argentina (irrespective of the obligor's location), (b) the receivable is governed by the law of Argentina, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Argentina recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Argentina and any third party creditor or insolvency administrator of any such obligor)?

Please see our answer to question 3.4.

## 4 Asset Sales

**4.1 Sale Methods Generally.** In Argentina what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

The customary method will be an assignment contract, listing the sold receivables and the names and domiciles of the debtors thereunder. When the receivable is under litigation, a sale of real estate, a credit secured with real estate or originally documented in a public deed, the purchase agreement will need to be documented in a public deed in order to be effective. For securitisation purposes, receivables are usually assigned to a trust (under Argentine law - trust), and the property of such receivables segregated from other property of the trustee. See the response to question 7.2. The customary terminology is "assignment".

**4.2 Perfection Generally.** What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

The sale of receivables is legally effective between the purchaser and seller upon the execution of the assignment agreement and with the delivery of the receivable contracts to the purchaser or a custodian (for instance, the seller). However, as a general principle, for the sale of any receivable (except for the ones specified below in this questionnaire), the law requires prior written notice to the debtor of such assignment in order to produce legal effects towards the debtor and third parties. Upon such notice: (a) the seller ceases to be the owner of the receivable, and he can no longer assign that credit, receive payments from the debtor or take any action in connection with the collection of that credit; (b) the debtor shall be notified of his creditor's identity; and (c) third parties shall know the assignor's condition with regard to the assigned credit.

Regarding the formalities of the notice, in order for the sale to be effective against the debtor (excluding third parties), the law does not require a particular formality for the notice to the debtor of the assignment of the receivable, it being thus possible to give such notice through a private letter, a telegram, through the notice of the complaint against the debtor or even verbally.

However, for the transfer to be effective *vis-à-vis* third parties other than the debtor, the law requires that the notice complies with

certain formal conditions that provide authenticity to the fulfilment of the notice requirement, that is to say, through a public act. By “public act”, jurisprudence and scholars’ opinions have deemed that the participation of a public officer (i.e. public notary, courts) implies the existence of a public act. Depending on the quantity and size of the loans to be transferred, hiring notaries to serve notices to each debtor has a tremendous impact on the cost and timing of any transaction. Instead, to meet the “public act” requirement, the securitisation industry in Argentina has been publishing notices in the federal official gazette. There is no court precedent that has confirmed yet that publishing general notices complies – or does not comply – with such legal standard.

A remarkable exception to the notice requirement has been established through the Law of Trusts No. 24,441 (trusts under Argentine law are different to Anglo-Saxon trusts), which provides that the sale of the receivable without notice of the assignment may still be enforceable *vis-à-vis* third parties when the transfer is made to: (i) ensure the issuance by public offering of securities; (ii) incorporate the assets to a company, in order to securitise them by public offering, being the services and interest guaranteed by those assets; (iii) incorporate the assets so as to create a fund of loans. In those cases, no notice will be required when it is expressly established in the receivable contract.

Among other transfer of assets that have to be recorded, and regardless of whether notice is required, any transfer of a mortgage securing a loan has to be recorded with the real estate registry of the province where the relevant real estate is located. This recording impacts on the cost and timing of any transaction structure.

To avoid such a costly burden applicable to mortgage loans, Law No. 24,441 has also admitted the issue of mortgage securities upon the existence of a mortgage loan in the first degree of preference, which expressly authorises such issuance in the act of agreeing on the loan and creating the mortgage on the property. The issuance of the mortgage security shall be registered by the registry of real estate. The mortgage security represents the right of the seller under the mortgage loan. Once its creation has been recorded, it can be transmitted without the need to give any notice to the debtor or recording the transfer with the real estate registry. Nowadays, standard forms of mortgage loans suggested by the Central Bank and used by banks include the creation of mortgage securities in order to facilitate sales and securitisations.

Mortgage securities are usually book-entry securities. In this case, the designation of the entity in charge of the records of this kind of mortgage securities (where the public deed of the mortgage shall be deposited) shall be expressly registered within the corresponding registry of real property. The register of the mortgage securities shall be under the charge of clearing houses, banks or corporations organised exclusively for such purposes. Transfer of these kinds of mortgage securities shall be registered with such entity upon the filing of the corresponding transfer instrument, and it shall produce legal effects with respect to the debtor and third parties without any need to give notice of such transfer or registration to the registry of real property.

---

#### 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

---

The general regime described in question 4.2 above is applicable also to the sale of consumer loans and of mortgage loans. With regard to the sale of Promissory Notes, their sale and perfection is effected by endorsement of the note. Finally, with respect to

marketable debt securities, it is only necessary to notify the agent that holds the register of ownership of sold securities.

---

#### 4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

---

Please refer to the first two paragraphs of the answer given to question 4.2. As long as the receivables contract does not expressly prohibit assignment, it is not necessary for the seller or for the purchaser to obtain the debtors’ consent to the sale of receivables. To the contrary, if the contract prohibits (or in any other manner, restricts) the assignment, the debtors’ consent should be obtained. Notice perfects the assignment *vis-à-vis* third parties. Other benefits of notice are: (a) the seller ceases to be the owner of the receivable, and he can no longer assign that credit, receive payments from the debtor or take any action in connection with the collection of that credit; (b) the debtor shall be notified of his creditor’s identity; and (c) third parties shall know the assignor’s condition with regard to the assigned credit.

---

#### 4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

---

The notice or acceptance to be delivered to the debtor does not need to fulfil any specific requirements; any means is considered appropriate to notify. Please refer to the first two paragraphs of the answer to question 4.2. According to Section 1,464 of the Argentine Civil Code, in case of insolvency of the seller, the notice of the assignment – or its acceptance – could be delivered after the default of payments, but it will be ineffective against the creditors of the insolvency estate if it is delivered after the proceedings of the insolvency declaration.

---

#### 4.6 Restrictions on Assignment – General Interpretation. Will a restriction in a receivables contract to the effect that “None of the [seller’s] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]” be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says “This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]” (i.e., the restriction does not refer to rights or obligations)?

---

Regarding receivables contracts, both clauses lead to the same practical result, which requires the consent of the obligor. Notwithstanding, the first clause emphasises the rights and

obligations individually considered, while the second clause considers the contractual position as a whole.

- 4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Argentina? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Argentina recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

The restrictions mentioned above are applicable in Argentina, provided they do not contravene the “public order” – set of fundamental principles on which the social organisation is established – which limits party autonomy.

Regarding the breach of the aforementioned clauses, the seller will undoubtedly have to indemnify the debtor for any loss arising from the illegal act.

- 4.8 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells *all* of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

Other than identifying the original amount and the debtor, there are no statutory additional rules regarding the identification of sold receivables. The more information is provided, the higher the likelihood of avoiding potential litigation.

- 4.9 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

None of the economic characteristics above will prevent perfection of the sale. A provision by which an option is granted to the seller to repurchase the receivables may, according to some court precedents and scholars’ opinions, prevent not only perfection, but may also affect the validity of the sale.

- 4.10 Continuous Sales of Receivables.** Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes, he can. However, the agreement to make continuous sales will not be enforceable in the event of insolvency of the seller.

- 4.11 Future Receivables.** Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Argentine law permits the sale of future receivables. Thus, the seller can voluntarily transmit *inter vivos* future receivables without any specific form different from that required in question 4.2. Argentine law governs the general principle of freedom of forms, as stated in Section 1,278 of the Argentine Civil Code. In connection with enforcement in the insolvency scenario of the seller, please see question 6.5 below. Finally, Argentine law does not permit the sale of future mortgages or pledges or those that were not created at the time of the sale. This restriction will not apply to the assignment of the agreement from which future credits will arise.

- 4.12 Related Security.** Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Unless prohibited under the security contract itself, pursuant to Section 1,458 of the Civil Code, the sale/assignment of a receivable (credit) automatically includes all related securities thus entitling the new creditor to enforce such securities. It is customary, however, to serve notice of the transfer to third parties that granted such securities (e.g., the owner of the mortgaged land, a pledgor of personal property, etc.).

- 4.13 Set-Off; Liability to Obligor.** Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?

The obligor has the attribution to file against the purchaser all exceptions that concern the seller for which purpose Argentinian law does not require the obligor to make any reservation of right at the moment of being notified of the sale or its acceptance.

Nevertheless, upon the obligor’s receipt of notice of the sale, his right to set-off against the purchaser terminates.

Unless the parties have agreed, the prohibition of the transfer of credit, neither the seller nor the purchaser will be liable to the obligor for damages caused by such termination.

## 5 Security Issues

- 5.1 Back-up Security.** Is it customary in Argentina to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

Please note that in all transfers of rights for valuable consideration

there exists a legal and implied guarantee of the validity of the title (*garantía de evicción*), that is to say; Argentine law foresees that if a purchaser, due to a cause prior to, or contemporaneous with, the acquisition, by virtue of a judgment has deprived totally or partially of the rights acquired or suffers any other loss with respect to its ownership, enjoyment or possession rights, the purchaser has the right to be indemnified by the seller. Otherwise, it is not customary in Argentina to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security with the exception of certain indemnities that are usually included in certain contracts. Finally, it is customary to provide certain contractual provision ensuring that all the steps of the transfer of rights are dully followed.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Argentina, and for such security interest to be perfected?**

Please refer to the answer to question 5.1 above. With respect to the indemnities and the contractual provisions mentioned in question 5.1 above, they usually do not have special formalities to be deemed legal.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Argentina to grant and perfect a security interest in purchased receivables governed by the laws of Argentina and the related security?**

The requirements to be fulfilled depend on the type of security to be created. The most common security interests that are granted are the pledge, the collateral trust and the assignment. The requirements to be fulfilled in the case of the pledge and in the assignment are very similar. For example, the most important requirements are that: (a) the debtor of the pledged/assigned credit be notified (though there are certain exemptions in cases regarding assignments to trusts that publicly offer securities); (b) the credit be evidenced by a written document; (c) the document in which the credit is evidenced be delivered to the creditor or to a third party; and in the case of the pledge agreement (d) it should be perfected through a public deed or a private document with the true date and it will have to indicate the amount of the secured obligation.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Argentina, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Argentina or must additional steps be taken in Argentina?**

In principle it should be treated as valid and perfected in Argentina. Nevertheless, in the case of a security interest over receivables payable in Argentina, an Argentine court could consider such receivables movable assets with a permanent situation in Argentina (please refer to the answer to question 2.1 above), and therefore construe the validity and efficacy of the said security interest in light of Argentine law.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

The requirements to be complied with depend on the type of

security interest created and the assets to which such security interest applies. It is worth pointing out, however, in the case of a pledge (a security interest frequently created under our law), that if the same was to apply to certain negotiable securities originated in accordance with Argentine law and transmissible by means of endorsement, the notification of the granting of the security interest to the assigned debtor could be dispensed with. In general, when granting a loan or financing any payment, the lender will require the debtor to pay a life insurance linked to the loan covering the loan or credit balance. In case of a mortgage or pledge, an additional insurance covering the asset shall be taken out. Regarding insurance requirements, if the security interest was a mortgage loan or a pledge granted by certain financial entities regulated by law (such as banks), the mentioned life insurance linked to the loan is mandatory.

**5.6 Trusts. Does Argentina recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?**

Yes, it does (*fideicomisos*).

**5.7 Bank Accounts. Does Argentina recognise escrow accounts? Can security be taken over a bank account located in Argentina? If so, what is the typical method? Would courts in Argentina recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Argentina?**

The most common legal figures to be used are the collateral trust or the commercial pledge over the bank accounts and the amounts deposited therein. In this sense, Section 3,207 of the Argentine Civil Code provides for a pledge “in the hands of a third party” as different from a pledge in the hands of the creditor. However, the trust would be safer than the pledge (since a third neutral party – the trustee – should be the holder of the account). In case of a pledge, it works as any other pledge over contractual rights (e.g. the rights over the opening account contract) and the pledgor remains the owner of the account. With respect to the foreign law provision of security taken over a bank account located in Argentina, in principle, it should be treated as valid and perfected in our country.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

If the security was validly granted, the secured party will have control on all cash flowing into the account. However, please see the comments made in case of insolvency proceedings (response to question 6.5, among others).

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

It will depend on the wording and limitations imposed by the security agreement itself.

## 6 Insolvency Laws

- 6.1 Stay of Action.** If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Argentina's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

The Argentine Bankruptcy Act contemplates three types of insolvency proceedings: bankruptcy reorganisation (*concurso preventivo*); out-of-court composition with creditors (but with limited court intervention after an agreement is reached) (*acuerdo preventivo extrajudicial*); and bankruptcy liquidation (*quiebra*). If the sale has been perfected in conformity with the law and if there has been a true sale, neither the opening of a bankruptcy reorganisation of the seller, nor the application for out-of-court composition with creditors, nor the declaration of bankruptcy liquidation of the seller could prevent, or give reasons for, an official insolvency to prevent the exercise of the rights of the purchaser over the acquired receivables.

- 6.2 Insolvency Official's Powers.** If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?

If the sale has been performed in accordance with the law and if there has been a true sale, the insolvency official could not prohibit the purchaser's exercise of rights.

- 6.3 Suspect Period (Clawback).** Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Argentina for (a) transactions between unrelated parties, and (b) transactions between related parties?

Under bankruptcy liquidation proceedings, acts exist that could be directly ineffective by virtue of the law or, in other cases, by virtue of a court resolution. The Argentine Bankruptcy Act contemplates a "suspect period" which takes place between the date on which the suspension of payments (*cesación de pagos*) began and the date of the bankruptcy adjudgment, even though, for the purposes of this matter, the date of suspension of payments (*cesación de pagos*) cannot be backdated further than two years from the date of the bankruptcy liquidation adjudgment or of the bankruptcy reorganisation filing (provided that it has preceded the relevant bankruptcy liquidation). The Argentine Bankruptcy Act envisages that the following acts performed by the debtor within the "suspect period" are directly ineffective by virtue of the law in respect of the creditors': (a) gratuitous acts; (b) anticipated payment of debts whose expiration should have occurred on the date of the bankruptcy liquidation adjudgment or later; and (c) the granting of a mortgage, pledge or any other preference, with respect to a non-expired obligation that originally did not have such security interest. On the other hand, other acts prejudicial to creditors, celebrated during the "suspect period",

can be ruled ineffective by the bankruptcy court, if the third party that celebrated the act with the insolvent party had knowledge of the suspension of payments (*cesación de pagos*) of the debtor. It should also be mentioned that it is the third party that celebrated the act with the insolvent party that must prove that such act did not prejudice the creditors. All that has been explained is with regard to bankruptcy liquidation but is not applicable to bankruptcy reorganisation or out-of-court composition with creditors. Lastly, we should mention that in the Argentine Civil Code the possibility of filing an action for fraud exists as envisaged with respect to all acts that may have caused, or aggravated, the insolvency of the debtor.

- 6.4 Substantive Consolidation.** Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Under the Argentine Bankruptcy Act, where two or more individuals or legal entities comprise permanently an economic group, they can request jointly their bankruptcy reorganisation stating the facts upon which the existence of the economic group is based. The request must include all the members of the group without exception. The bankruptcy court may dismiss the request if it should consider that the existence of the group is not evidenced. Within the context of bankruptcy reorganisation proceedings of an economic group, the appointed receiver must prepare, apart from specific reports, a statement of consolidated assets and liabilities of the insolvent group. The regulations governing bankruptcy reorganisation proceedings of an economic group are also applied to those that by means of any legal act may have guaranteed the obligations of an insolvent party and that may have applied for its bankruptcy reorganisation proceedings to be filed together with that of its guaranteed party. On the other hand, in the case of bankruptcy liquidation, the law envisages some cases of extension of the bankruptcy liquidation in which, if there exists confusion of assets between the original insolvent party and those to whom the declaration of bankruptcy has been extended, a sole mass of assets is formed in respect of all the creditors of the related parties adjudgment bankrupt.

- 6.5 Effect of Proceedings on Future Receivables.** If insolvency proceedings are commenced against the seller in Argentina, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

In general, we can say that if the price for the receivable was already paid, the purchaser will collect his claim in the same conditions as any other unsecured creditor. Moreover, if the price was not yet paid, performance of the contract will be conditioned to the decision of the bankruptcy judge. An important issue in this respect is the financing of the production of the good for which the future receivable will be created.

- 6.6 Effect of Limited Recourse Provisions.** If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?

There are three requirements for a bankruptcy claim: (i) a breach; (ii) this breach has to be a revealing fact of the debtor insolvency;

(iii) the debtor must be capable of being declared in bankruptcy. Once these requirements are fulfilled, the bankruptcy would be declared without a trial to assess the validity and enforcement of a Limited Recourse Provision.

negligently or with willful misconduct. In general, the contractual provisions mentioned above will be legal, provided that public policy is not breached and none of the parties take advantage of the other party's negligence.

## 7 Special Rules

### 7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Argentina establishing a legal framework for securitisation transactions? If so, what are the basics?

There is no law that specifically provides for securitisation transactions. The one that is probably more specific is Law No. 24,441. Furthermore, in case the securitisation transactions involve public offering of securities the applicable law will be Law No. 26,831.

### 7.2 Securitisation Entities. Does Argentina have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Yes, it does. It is Law No. 24,441, which governs the creation of "financial" trusts, in other words, trusts that issue securities. Under Argentine law, the trust is not an entity, but is an estate separate from those of the trustee (purchaser) and the settler (seller). Accordingly, assets of the trust shall not be the target of any action by the trustee's and seller's creditors and their respective bankruptcies (except fraud). The trustee is in charge of the operation and management of the business of the trust. Only banks licensed in Argentina and entities authorised by the National Securities Commission may act as trustees. The trustee shall not be personally liable to any obligation of the trust, which shall only be payable with the assets of the trust, except when the trustee acted negligently or with willful misconduct. The entities authorised by the National Securities Commission are required to meet a relatively low solvency requirement.

### 7.3 Limited-Recourse Clause. Will a court in Argentina give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

Yes, it is highly probable that a court will hold such a contractual provision among the parties as valid.

### 7.4 Non-Petition Clause. Will a court in Argentina give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

As long as the purchaser is a trust, a trustee would not be personally liable to any obligation of the trust, which shall only be payable with the assets of the trust, except when the trustee acted

### 7.5 Priority of Payments "Waterfall". Will a court in Argentina give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

In regular situations, the answer will be yes. In the case of insolvency proceedings, and generally speaking, the court would give effect to the subordination of a credit to others.

### 7.6 Independent Director. Will a court in Argentina give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

In principle, such a provision should be treated as valid and perfected in our country. However, in case the provision forbids the directors to take certain actions in specific sensitive subjects, it could be declared by the acting court to be against Argentina's public policy (see the response to question 3.4 above, among others).

## 8 Regulatory Issues

### 8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Argentina, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Argentina? Does the answer to the preceding question change if the purchaser does business with other sellers in Argentina?

Foreign companies are authorised by the Argentine Companies Law to perform "isolated" acts of commerce in Argentina. Acts of commerce on a "habitual" basis require the registration of the purchaser. The answer would depend on the circumstances of the case and it would depend on the size and characteristics of the receivable portfolio acquired. However, in practice, due to tax and foreign exchange reasons, receivable portfolios are usually acquired by a locally-organised trust and, depending on whether or not funds are offshore or onshore, foreign investors would not need to be registered to do business in Argentina to purchase the securities issued by the trust with, as a consequence, less foreign exchange restrictions.

### 8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

If the seller is an Argentine company, no special licence would be required. However, it could be required to present a power of attorney to appear before a court. If it is a foreign company, it is probably convenient and, depending on the circumstances, in some cases mandatory that the foreign company becomes registered



under either Section 118 or 123 of the Business Associations Law (No. 19,550, as amended).

---

**8.3 Data Protection. Does Argentina have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

---

Several rules protect the data provided by obligors, the most relevant being Law No. 25,326. It not only applies to consumer obligors, but also to enterprises. Please note that Argentina has a vast and strict data protection regime. For instance, Argentine data protection regulations require to collect the data owners' (who can be individuals or legal entities) prior, written, express and informed consent for any kind of processing of their personal data (except for a few exceptions). We remain at your disposal to analyse any specific measures or precautions to be taken regarding a particular project/situation.

---

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Argentina? Briefly, what is required?**

---

Debtors of the sold receivables are considered to be consumers. Thus, the purchaser should have to comply with several consumer protection rules, the most relevant being Law No. 24,240. Among other relevant requirements, that law requires: (i) giving true, objective, detailed and sufficient information of the given services, and respect all terms and conditions as they have been published and agreed; and (ii) avoiding clauses that restrict the rights of the consumer or enlarge the faculties of the other party. In case of doubt in the interpretation of a clause, that which is most favourable to the consumer will always prevail.

---

**8.5 Currency Restrictions. Does Argentina have laws restricting the exchange of Argentina's currency for other currencies or the making of payments in Argentina's currency to persons outside the country?**

---

Yes, there are several, especially when foreign investors invest in securities issued by a trust organised in Argentina. There are restrictions to inflows, outflows and to the purchase and sale of foreign currency notes in Argentina. Restrictions vary depending on whether the person operating in the foreign exchange market is a resident or a non-resident of Argentina.

## 9 Taxation

---

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Argentina? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

---

The obligation to perform withholdings and applicable rates may vary depending on the nature of the receivables and the location of

the beneficiary of the payment. For instance, in case the recipient of the payment is a local resident and interest is being paid, debtors who are companies or individuals that borrowed money for their business, have to make income tax withholdings on interest payments to the lenders. The withholding rate may vary from 3 per cent to 35 per cent. In principle, receivables originated in consumer loans are not subject to withholding. The purchaser of receivables may have to perform these withholdings, substituting the debtor, upon payment to the seller. In the case of the payment of interest to non-residents, withholding rates may vary from 15.05 per cent to 35 per cent depending on the beneficiary and his country of residence. In case a Double Taxation Treaty is applicable, this rate may be lower. In addition, the sale of receivables may also be subject to income tax withholdings.

---

**9.2 Seller Tax Accounting. Does Argentina require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

---

No specific accounting policy must be adopted.

---

**9.3 Stamp Duty, etc. Does Argentina impose stamp duty or other documentary taxes on sales of receivables?**

---

The receivable purchase contract may be subject to stamp tax in Argentina's provinces and in the City of Buenos Aires (Argentina is a federal country). However, most jurisdictions exempt sellers and purchasers from stamp tax as long as the transfer was made for the purpose of a securitisation deal and the securities are registered with the CNV.

---

**9.4 Value Added Taxes. Does Argentina impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

---

As a general rule, the sale of goods or services is levied by VAT with a 21 per cent rate. The sale of certain goods or services may be levied with lower or higher rates depending on the specific goods or services. The fees for collection agent services are also taxed with VAT at a 21 per cent rate. In the case of sales of receivables, VAT is imposed at the rate of 21 per cent on the spread between the value of the portfolio and actual purchase price. However, sales to a trust organised under Argentine law (the vehicle used for securitisation deals and the purchase of distressed credit portfolios in Argentina) are exempt from VAT.

---

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

---

Unless the receivables are part of the assets sold in the transaction qualifying as a Transfer of a Going Concern (Law No. 11,867), the principle is that the tax authority would only claim against the party that is liable. If the transaction qualifies as a part of a Transfer of a Going Concern, special procedures must be accomplished to exempt the purchaser from the tax liabilities of the seller. In the case of stamp tax, both parties are jointly and severally liable to pay the tax.

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Argentina, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Argentina?**

No, not as long as the purchaser does not reside or have a domicile in Argentina and does not maintain a permanent establishment in

Argentina. If you consider a sole transaction of the purchase of receivables, the appointment of a servicer and the enforcement, we do not think that a purchaser would become personally liable for taxes in Argentina. However, depending on the circumstances, the debtor or the collection agent would have to make high withholdings on interest payments due to the fact that the creditor is domiciled abroad. For this reason, it would probably be more efficient to organise a local vehicle or a trust for the purchase.



**Damián F. Beccar Varela**

Estudio Beccar Varela  
Tucumán 1, piso 3  
1049AAA, Buenos Aires  
Argentina

Tel: +54 11 4379 6800  
Fax: +54 11 4379 6860  
Email: [damian@ebv.com.ar](mailto:damian@ebv.com.ar)  
URL: [www.ebv.com.ar](http://www.ebv.com.ar)

Damián F. Beccar Varela is a grandson of the founder of the firm. He graduated as a lawyer in Argentina and was admitted to the Buenos Aires Bar Association in 1967. In 1967/68 he practised as a foreign associate at the firm of Casey Lane & Mittendorff in New York, N.Y. In 1972 he was a foreign visiting assistant professor at, and at the same time attended, graduate courses at the University of Illinois at Champaign-Urbana, Illinois, U.S.A. A partner of the firm since 1971, in 1986 he was elected Senior Partner of the firm and continues to discharge such position. His personal specialty practice areas include international business transactions and finance agreements and mergers and acquisitions. He was a head member of the team of lawyers during the years when his firm was the Argentine counsel of the international banking community in respect of the renegotiations of the Argentine foreign debt and led the majority of the teams that dealt with corporate restructuring, mergers and acquisitions, joint ventures, and complex financing agreements. He speaks, reads and writes Spanish, English, French and Italian.



**Roberto A. Fortunati**

Estudio Beccar Varela  
Tucumán 1, piso 4  
1049AAA, Buenos Aires  
Argentina

Tel: +54 11 4379 6839  
Fax: +54 11 4379 6860  
Email: [rfortunati@ebv.com.ar](mailto:rfortunati@ebv.com.ar)  
URL: [www.ebv.com.ar](http://www.ebv.com.ar)

Roberto A. Fortunati is a partner of the firm. His professional activity is mainly concentrated in banking, and corporate finance with a focus in the oil and gas and mining sectors. He has also been acting as consultant to the World Bank in insolvency matters. Mr. Fortunati acted as leading local counsel for several major project financings, mainly related to mining, oil and gas, and utilities. He has been very active in the fields of out-of-court debt restructurings (work-outs), privatisation of state-owned companies, mergers and acquisitions and in the start-up of venture capital investments. He is member of the board of directors of several corporations, including acting as independent director and a member of auditing committees, and an arbitrator to the MAE (the local OTC electronic market). He is a member of the Advisory Board of the School of Law of Torcuato Di Tella University, Buenos Aires, and teaches project financing in a postgraduate course on Oil and Gas Law, at the School of Law of the University of Buenos Aires. Mr. Fortunati founded the firm Fortunati & Asociados in early 2003, a firm which has recently merged with Estudio Beccar Varela. He acted as General Counsel of Citibank in Argentina, after being partner of Estudio Beccar Varela, in Buenos Aires. Mr. Fortunati started his professional career as in-house counsel of Amoco Argentina Oil Company. He graduated from the Law School of the University of Buenos Aires in 1979.

**ESTUDIO BECCAR VARELA**

DESDE 1897

Estudio Beccar Varela is an Argentine law firm based in the city of Buenos Aires. For more than a century it has counselled and advised its clients in all aspects of corporate and financial law. It is frequently involved in many of the largest Argentine banking and corporate transactions and has demonstrated a sophisticated level of expertise to structure operations which match the international legal frame with the local legal environment. Many of the firm's clients have been serviced by the firm for over 70 years, the oldest current client being Citibank, N.A., since 1914.

The firm's practices include corporate law, banking law, capital markets, mergers and acquisitions, insurance law, natural resources law, litigation, labour, tax, customs, administrative, intellectual property law and trademarks and patents law, antitrust and consumer protection law.

The firm is one of the leaders in the securitisation practice in Argentina. For almost 15 years now since the securitisation practice has been common practice with the passing of Law No. 24,441 (Trust Act), the firm has been advising arrangers, sellers, issuers, trustees, rating agencies and even foreign sovereigns.

# Australia



Anne-Marie Neagle



Ian Edmonds-Wilson

King & Wood Mallesons

## 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

(a) There is no general requirement that an agreement for a sale or a provision of services be evidenced by a formal written contract between the parties. However, certain contracts do require the formality of writing, such as contracts for the sale of land (or interests in land) and credit contracts regulated under the *National Consumer Credit Protection Act 2009* (Cth) (“NCCPA”) (which also mandates detailed form and content requirements). In some cases, electronic transactions legislation may allow a contract “in writing” to be entered into other than using a physical paper agreement. The *Personal Property Securities Act 2009* (Cth) (“PPSA”) requires the agreement to be evidenced in writing that is either signed by the seller or adopted by the seller by conduct.

(b) Where no special rules such as those noted in (a) apply, an invoice may be sufficient evidence of contractual relations provided that the basic requirements of contract formation are met (namely offer, acceptance, consideration, certainty, capacity and intention to create legal relations).

(c) Where no special rules such as those noted in (a) apply and the basic requirements of contract formation highlighted in (b) are met (including an intention to create legal relations), the conduct of the parties may be sufficient for a contract to be deemed to exist.

**1.2 Consumer Protections. Do Australia’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

The NCCPA regulates loans and leases (and e.g. associated guarantees and mortgages) entered into with consumers, and regulates matters such as the contract form, disclosures and conduct. Where the receivables are margin loans, these will be regulated by relevant provisions of the *Corporations Act 2001* (Cth) (“CA”) rather than the NCCPA and will be subject to their own disclosure, licensing and responsible lending regime.

- (a) Under the NCCPA:
  - restrictive charging provisions apply to small amount credit contracts; and
  - a general cap of 48 per cent applies to credit contracts, calculated as provided in the NCCPA.
- (b) There is no express statutory right to demand payment of default interest under statute in Australia. However, this is a commonly accepted contractual term and, subject to meeting certain requirements, is not prohibited.
 

Default interest is permitted under the NCCPA if it is only imposed on an event of default, only in respect of the amount in default and only while that default continues.

The right to default interest should also be clearly set out in the contract and the amount should not be so high as to constitute a penalty or be considered unconscionable or unfair.
- (c) Unless the contract prohibits its early repayment, a credit provider must accept early payments under NCCPA regulated contracts. The NCCPA also restricts early termination charges and obliges credit providers and lessors to consider applications for contract variation due to hardship (e.g. illness or unemployment).
- (d) Consumer protection legislation (including the NCCPA), provides consumers with extensive rights and protections. Other key protections include:
  - obligations relating to responsible lending, disclosure and contractual form; and
  - consumer rights of contractual review, to have unfair terms declared void, to access external dispute resolution schemes (which may have regard to “fairness” generally rather than strict legal obligations, and cannot be appealed) or to have a court reopen an unjust transaction.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

The application of relevant rules to contracting with government will depend on which “arm” of the “government” a party is contracting with (e.g. whether it is the Commonwealth or a state, and whether it is the Crown in the right of the Commonwealth or a state or a separate statutory corporation formed under federal or state law). Government contracts for receivables are generally subject to the same requirements and laws as contracts between other persons, but there can be some modifications in their application (for example, the powers of the Commonwealth are limited by the Constitution and a statutory corporation will only

have the powers enumerated in its constituting statute). Other important points to note include:

- the parliament of the Commonwealth or a state or territory can pass laws that affect a contract it has previously entered into;
- enforcement against the Crown is subject to special procedures under Crown proceedings legislation;
- the payment of a debt owed by the Crown from government revenue must be authorised by legislation; and
- in very limited cases, executive necessity may allow the Crown to breach a contract without penalty on the basis of its public responsibility.

## 2 Choice of Law - Receivables Contracts

### 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Australia that will determine the governing law of the contract?

In these circumstances, an Australian court will generally determine the governing law by:

- first, assessing whether an implied choice of law can be inferred as a matter of contractual construction; and
- next, if no such implied choice of law can be inferred, by identifying the law with the closest and most real connection to the contract (having regard to factors such as the place of residence and business of the parties).

### 2.2 Base Case. If the seller and the obligor are both resident in Australia, and the transactions giving rise to the receivables and the payment of the receivables take place in Australia, and the seller and the obligor choose the law of Australia to govern the receivables contract, is there any reason why a court in Australia would not give effect to their choice of law?

Australian courts will generally give effect to an express choice of law, subject to that choice being *bona fide*, there not being any public policy reason for not giving effect to the choice of law, and to the choice of law not infringing any statute of the forum. On the facts of the base case, it is unlikely that any of the vitiating factors would apply.

### 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Australia but the obligor is not, or if the obligor is resident in Australia but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Australia give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

See question 2.2. Australian courts will generally give effect to an express choice of foreign law subject to the exceptions noted.

If questions of foreign law arise in Australian courts, the party asserting a particular effect of foreign law must prove that effect by providing expert evidence, and the Australian court treats the effect as a question of fact to be established by evidence.

### 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Australia?

Yes. Australia acceded to the Convention on 1 April 1989 and, as a consequence of implementing legislation, the Convention has the force of law and will generally prevail over local law to the extent of any inconsistency.

## 3 Choice of Law - Receivables Purchase Agreement

### 3.1 Base Case. Does Australia's law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Australia's laws or foreign laws)?

There is no general rule in Australia that the sale of the receivables needs to be governed by the same law as the receivables themselves and, subject as noted in question 2.2, Australian courts will generally respect a choice of law. However, the law of the receivable is still relevant (for example, in construing the rights and obligations of the parties to the receivable contract).

The PPSA has separate conflict of law rules which are complex. Generally speaking, the PPSA applies to a transfer of receivables if the seller is located in Australia or if the receivable is an Account or Chattel Paper payable in Australia. One or both of these are satisfied in most Australian securitisations. If the PPSA applies then:

- perfection as against the debtor is governed by the PPSA rules (see question 4.2); and
- perfection as against third parties asserting a competing interest in the receivable is generally determined by the laws of the jurisdiction in which the seller is located. However, because of the complexity in this area, we expect practice to be that purchasers will register even if the seller is located outside Australia.

### 3.2 Example 1: If (a) the seller and the obligor are located in Australia, (b) the receivable is governed by the law of Australia, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Australia to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Australia, will a court in Australia recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

As the seller is located in Australia, Australian requirements would apply as described in question 3.1.

### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Australia, will a court in Australia recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

As the seller is located in Australia, Australian requirements would apply as discussed in question 3.1. However, the law of the obligor's country may also be relevant, particularly if it has rules on how the obligation can be transferred.

- 3.4 Example 3:** If (a) the seller is located in Australia but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Australia recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Australia's own sale requirements?

Same as question 3.3.

- 3.5 Example 4:** If (a) the obligor is located in Australia but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Australia recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Australia's own sale requirements?

If the obligor's debt is payable in Australia, Australian requirements will apply as discussed in question 3.1 in addition to the requirements of the seller's country.

- 3.6 Example 5:** If (a) the seller is located in Australia (irrespective of the obligor's location), (b) the receivable is governed by the law of Australia, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Australia recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Australia and any third party creditor or insolvency administrator of any such obligor)?

As the seller is located in Australia, Australian requirements would apply as discussed in question 3.1 in addition to the other applicable requirements.

## 4 Asset Sales

- 4.1 Sale Methods Generally.** In Australia what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

In Australia a sale of receivables is generally by way of legal or equitable assignment.

Under a legal assignment, legal and equitable title pass to the purchaser, who becomes sole owner of the receivable. A legal assignment must be an absolute assignment in writing of the whole of a present debt, with written notice to the debtor.

Equitable assignments are more common in securitisation transactions, under which the purchaser obtains beneficial ownership of the receivable, but legal title remains with the seller.

An equitable assignment requires valuable consideration and a clear intention to assign identifiable receivables and may have additional risks including that:

- the debtor may be fully discharged by paying the seller, and may exercise set-offs against the seller (see question 4.13);
- the seller may sell the same receivable to another purchaser (PPSA registration (see question 4.2) and otherwise notice to the debtor can overcome this); and
- the purchaser may need to join the seller in actions against the debtor.

- 4.2 Perfection Generally.** What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

Perfection is governed by property law statutes in the various Australian states and territories and by the rules of equity. The PPSA also imposes separate but overlapping perfection rules where the receivables are "Accounts" or "Chattel Paper" under the PPSA, which will be the case in most Australian securitisations.

"Perfection" in this context has two elements:

- obtaining the best interest against the debtor:
  - a legal assignment is fully perfected against the debtor and an equitable assignment can be perfected by notice to the debtor; and
  - under the PPSA, despite notice to the debtor, the debtor and the seller may modify the contract as it relates to payments that have not been fully earned by performance, but only if, amongst other things, this does not materially adversely affect a purchaser's rights; and
- obtaining best interest against third parties:
  - the interest of an assignee of Accounts or Chattel Paper is a deemed security interest under the PPSA, which can be registered under the PPSA giving a priority based on registration time against other interest holders (including other purchasers);
  - failure to register under the PPSA does not invalidate the assignment as against the debtor or any insolvency official appointed to the debtor;
  - where the receivable is Chattel Paper, a promissory note or certain other negotiable instruments, a holder of the original instrument may have PPSA priority over other registered assignees; and
  - where the PPSA does not apply, notice of assignment to the debtor will generally give priority over other interested parties who have not yet given notice.

- 4.3 Perfection for Promissory Notes, etc.** What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

The general rules are set out in questions 4.1 and 4.2. However, each of these debt classes raises specific issues. For example:

- an assignment of promissory notes does not require PPSA perfection;
- an assignment of mortgage loans may require registration of land mortgage transfers on land titles registers;
- assignment clauses in consumer loans can in some cases give rise to unfair contract terms issues; and

- marketable debt securities sold through clearing systems are subject to the rules of the clearing system.

**4.4 Obligor Notification or Consent.** Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

Notice of the assignment should be given to obligors as set out in questions 4.1 and 4.2.

If the receivables contract permits, or does not prohibit, an assignment, then obligor consent is not required.

If the contract prohibits assignment, but the receivable is an Account or Chattel Paper under the PPSA, then an assignment is valid regardless of lack of consent. However, the debtor may have contractual and tortious remedies arising out of contract breach.

**4.5 Notice Mechanics.** If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

The notice can be delivered at any time. However, payments occurring and competing interests arising before the notice is given are not affected by such notice.

For a legal assignment, the notice must be in writing.

If the PPSA applies, the notice must comply with the content requirements set out in the PPSA.

**4.6 Restrictions on Assignment - General Interpretation.** Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?

Australian courts would generally interpret each of these contractual restrictions as prohibiting a transfer or assignment of receivables by the seller to the purchaser without consent. However, where a contract requires consent and such consent is forthcoming, the assignment of contractual rights would be permissible.

It is likely that Australian courts would find no difference between the formulations above.

**4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Australia? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Australia recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

If the contract prohibits assignment, but the receivable is an Account or Chattel Paper under the PPSA, then an assignment is generally valid regardless of lack of consent. However, the debtor may have contractual and tortious remedies arising out of contract breach.

If the PPSA does not apply, a contractual restriction prohibiting assignment may mean that any assignment without consent is invalid between the obligor and the purchaser.

**4.8 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The sale document must adequately identify the receivables to be sold such that at any point in time those receivables that are subject to the assignment can be distinguished from those that are not by reference to the wording of the sale document. However, provided that the class of receivable being transferred can be and is identified with adequate certainty to distinguish it from other receivables, this need not be achieved through listing each specific receivable.

The receivables being sold do not need to share the same objective characteristics but it is quite common for receivables being sold to share specified "eligibility criteria".

A sale can generally be drafted to attach to all of the receivables of the seller, provided that "receivables" are sufficiently defined for these purposes, and a sale of all receivables other than specifically identified receivables (or adequately identified classes of receivables) can also generally be structured.

If receivables are secured by security over cars, ships, aircraft or certain intellectual property rights, then there may be benefits in registering that underlying security with respect to the serial number for those items.

**4.9 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

The language of the contract should clearly and expressly be that of a sale and the legal character of the rights and obligations created

by the terms of the contract should be consistent with that language. Australian courts are likely to look to the legal substance of the transaction rather than its economic substance. In particular, a court is likely to adopt a two-step analytical process:

- first, a determination of the rights and obligations the parties gave each other under the terms of the sale contract; and
- second, the characterisation of such rights and obligations as a matter of law (without regard to the intention of the parties).

The transaction must not be a “sham”. The parties must not disguise the transaction as a sale, if the true nature of the rights and obligations intended by the parties are not those of a sale.

Not all “retention” factors will undermine the characterisation as a sale. For example:

- it is common for the seller to act as servicer of the receivables;
- the purchase price may include variable or deferred elements; and
- the seller may provide indemnity protection for representations and warranties relating to the receivables.

In addition, a sale should not be re-characterised simply because the seller has a right to repurchase the transferred receivables. However, a right of repurchase may increase the risk of re-characterisation if it exists in conjunction with other features which, taken together, suggest the creation of legal rights and obligations inconsistent with those of a sale.

Under the PPSA, a transfer of Accounts or Chattel Paper is generally treated as a security interest regardless of economic effect. However, if a transfer of Accounts or Chattel Paper does “secure payment of a performance or obligation”, then the proceeds are subject to a mandatory waterfall which requires residual proceeds to be returned to the seller after the secured obligation has been satisfied. While this provision has not been interpreted, it seems unlikely that this will apply unless the whole transaction is re-characterised as a secured loan.

---

#### **4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

---

Yes, a present assignment of adequately identified future property for valuable consideration can be recognised in equity (but not at common law).

---

#### **4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?**

---

Yes, as per question 4.10. The sale should be for valuable consideration with the sale documentation including clear and unambiguous identification of the receivables to be assigned. The assignment of the future receivables should occur automatically by the terms of the sale contract without any further act being required. If properly drafted, the receivable should vest in the purchaser immediately upon coming into existence and there is some legal

authority to support the validity of the assignment after the commencement of a winding up of the seller. However, arrangements under which payments continue (at least for some period) to be made to the seller can potentially have an impact on the purchaser as although tracing of receipts may ultimately be possible, they will not be in an effective position to control receipts. See also question 6.5 and, in relation to the PPSA, above.

---

#### **4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

---

The formalities required for a legal assignment of related securities will depend on the type of related security involved. For example, a legal assignment of a real property mortgage will require the registration of a transfer of the mortgage on the relevant land titles register. Transfers of related securities regulated by the PPSA will need to be perfected by PPSA registration.

---

#### **4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

---

Australia recognises a number of different types of set-off. The effect of notice on these rights will depend on the type of set-off in question. Generally, notice will terminate the accrual of rights of contractual or statutory set-off, but will not terminate any accrued rights in respect of pre-notice cross-debts. An assignee will generally take subject to any such accrued rights of set-off and any other equities. In the case of equitable set-off, the assignee may in some circumstances take subject to equitable set-off in respect of both pre and post-notice cross-claims. Insolvency set-off is mandatory and self-executing, but the mutuality requirement for insolvency set-off will generally be destroyed by the assignment.

The mere operation of these principles to fix the rights of the parties is unlikely to give rise to liability for damages. However if, for example, the termination of set-off rights arose from an assignment in breach of the underlying agreement, the obligor may in some circumstances have a claim for contractual or tortious remedies such as damages in respect of the relevant breach.

---

## **5 Security Issues**

---



---

#### **5.1 Back-up Security. Is it customary in Australia to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

---

It is not customary to take “back up” security to address the risk that the sale is deemed by a court not to have been perfected.

**5.2 Seller Security.** If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Australia, and for such security interest to be perfected?

The security interest will need to be perfected by PPSA registration. See question 5.3.

**5.3 Purchaser Security.** If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Australia to grant and perfect a security interest in purchased receivables governed by the laws of Australia and the related security?

The most common form of security is a general security interest over all assets of the purchaser.

The security interest must be perfected by PPSA registration within prescribed time limits. It is possible to perfect security interests in some assets by possession or control only, with no registration, but this is unusual in the securitisation context.

**5.4 Recognition.** If the purchaser grants a security interest in receivables governed by the laws of Australia, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Australia or must additional steps be taken in Australia?

If the purchaser is an Australian company or an Australian registered foreign company, then the security interest must comply with Australian validity and perfection rules.

Where the purchaser is not Australian or Australian registered, the Australian conflict of laws rules for intangible property are complex. In practice, most security interests over receivables governed by Australian law are taken so as to comply with validity and perfection requirements in Australia. See further section 3.

**5.5 Additional Formalities.** What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

As a general matter, there are no additional or different requirements except as noted in section 4.

**5.6 Trusts.** Does Australia recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?

Australia recognises trusts.

Collection trusts are commonly used in Australian securitisation transactions. Collection trusts and turnover trusts may be security interests under the PPSA, and it is common to register them.

**5.7 Bank Accounts.** Does Australia recognise escrow accounts? Can security be taken over a bank account located in Australia? If so, what is the typical method? Would courts in Australia recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Australia?

Escrow accounts are recognised in Australia, but are uncommon. It is more common for the purchaser to take security over the payment bank account.

Security is commonly taken over bank accounts under a security agreement by way of charge or mortgage and perfected by PPSA registration. Tripartite arrangements with the account bank are recommended.

Where the security holder is an Australian authorised-deposit taking institutions ("ADI") and it is taking security over an account for which it is the account bank, it has absolute priority and registration is not required.

As a general rule, Australian courts will recognise and enforce foreign-law security over bank accounts in Australia. However, Australian rules for validity and perfection apply in most cases.

**5.8 Enforcement over Bank Accounts.** If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

The secured party, or any receiver appointed by it, controls all cash from enforcement forward. However, if the secured party does not control the bank account for the purposes of the PPSA, then certain statutory preferred creditors may have priority rights to the bank account, which can disrupt the secured party's control of the cash.

**5.9 Use of Cash Bank Accounts.** If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Yes, generally, as long as that is provided for in the terms of the security document.

## 6 Insolvency Laws

**6.1 Stay of Action.** If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Australia's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

If the sale of receivables is a true sale by way of legal assignment and has been perfected, a seller's insolvency should not interfere with a purchaser's rights in respect of the purchased receivables (subject to those matters discussed at question 6.3). If there has been a true sale but it is only by way of equitable assignment, the position may be more complex and practical issues may arise. If



there is any doubt as to whether the assignment has been perfected, an administrator or liquidator of the seller may obtain an interim injunction from a court staying the enforcement by the purchaser of its rights, pending judgment from the court as to whether the assignment has been perfected.

If the purchaser is deemed to be only a secured party (in the sense of holding a security interest such as a charge over the receivables) rather than the owner of the receivables, then, broadly, if the security interest:

- is a “circulating security interest”, it may in certain circumstances be void against the company’s liquidator;
- is not perfected, it will vest in the seller upon its going into administration or liquidation;
- is perfected by registration and by no other means and registration occurred within certain prescribed time periods, the interest will vest in the seller upon its going into administration or liquidation; and
- is perfected:
  - the purchaser will be bound by the statutory stay on enforcement during the administration of the seller; and
  - an administrator of the seller may be able to dispose of the receivables which are the subject of the security interest in the ordinary course of the seller’s business in certain circumstances.

---

### 6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

---

An insolvency official does not generally have the power to prohibit the purchaser’s exercise of rights in connection with an effective sale of receivables, other than in the circumstances discussed in questions 6.1 and 6.3. However, the insolvency official is not required to assist the purchaser where such assistance is necessary for the purchaser to exercise its rights.

---

### 6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Australia for (a) transactions between unrelated parties, and (b) transactions between related parties?

---

If a transaction takes place within a specified “suspect” or “preference” period, a liquidator may be able to have the transaction set aside if it is a “voidable transaction”. In general terms, voidable transactions include unfair preferences while the company was insolvent, uncommercial transactions while the company was insolvent, unfair loans and unreasonable director-related transactions. The suspect period depends on the type of voidable transaction (for example, it is generally six months from the commencement of administration or liquidation or unfair preferences, but this may be extended to either four or ten years in certain circumstances).

---

### 6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

---

Assuming that the purchaser and the seller are separate and

independent bodies, there is no statutory right or established Australian line of authority that would allow an insolvency official to consolidate their assets in insolvency proceedings. However, if the purchaser and the seller are related entities and/or their affairs are intermingled in a prescribed manner, it may be possible for a liquidator to obtain a pooling order or to make a pooling determination to permit the purchaser and the seller to be wound up on a pooled basis.

---

### 6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Australia, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

---

Once certain insolvency proceedings have been commenced:

- no sale of receivables can occur unless the relevant insolvency official or the relevant Australian court consents;
- if the contract has been entered into but the purchase price has not been paid (or the purchaser has not otherwise acquired a proprietary interest in the receivables), the purchaser will have an unsecured claim against the seller with regards to any loss the purchaser suffers; and
- if there has been a true sale of future receivables, and the purchaser has paid the purchase price in full prior to the initiation of administration or liquidation, then (subject to the discussion in questions 6.1 and 6.3) the seller’s insolvency alone will not affect the purchaser’s rights in relation to the receivables.

---

### 6.6 Effect of Limited Recourse Provisions. If a debtor’s contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?

---

In Australia, a company is insolvent if it cannot pay its debts as and when they fall due and payable. The equivalent position for vehicles established as trusts is more complicated, as a trust is not a separate legal entity from its trustee.

To our knowledge Australian courts have not specifically looked at the effect of limited recourse clauses on a company’s solvency. It is unlikely that Australian courts would consider that a limited recourse debt is “payable” to the extent that it exceeds the value of the assets to which a properly drafted limited recourse clause is directed such that the failure by a debtor to pay that portion of the debt which exceeded the value of the assets could render the debtor insolvent. However, we are aware of an English judgment to the contrary which, whilst not binding on Australian courts and made in unusual circumstances, may still be persuasive in some circumstances.

## 7 Special Rules

---

### 7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Australia establishing a legal framework for securitisation transactions? If so, what are the basics?

---

Although Australia does have a legislative framework for covered bonds, it does not have a specific legislative framework for securitisation. However, in the case of securitisations involving

ADIs, APS 120 (a prudential standard specific to securitisation established by our prudential regulator, which is currently under review) will apply. In addition, some Australian laws (such as stamp duty laws) make specific provision for securitisation in certain circumstances (for example in the form of exemptions), and many laws of general application will impact a securitisation transaction.

**7.2 Securitisation Entities. Does Australia have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

Australia does not have a specific legislative framework for the establishment of special purpose entities for securitisation.

Securitisation vehicles are most commonly established in Australia as special purpose trusts, but can also be established as special purpose companies.

**7.3 Limited-Recourse Clause. Will a court in Australia give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

Australian courts should generally give effect to a clause limiting the recourse of parties to specified assets provided that the contract itself is enforceable (and, in the case of a contract governed by the foreign law, that contract and the limited recourse clause are enforceable as a matter of the foreign law). However, see question 1.2 and section 8 in relation to consumer contracts.

**7.4 Non-Petition Clause. Will a court in Australia give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

Australian courts should generally give effect to a clause prohibiting a creditor from taking legal action or commencing an insolvency proceeding (subject to the corresponding provisos in question 7.3). However, see question 1.2 and section 8 in relation to consumer contracts.

**7.5 Priority of Payments "Waterfall". Will a court in Australia give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

Yes, an Australian court should generally give effect to properly drafted contractual provisions which provide for the application of proceeds from the enforcement of security over the securitisation vehicle's assets to the creditors bound by such provisions and entitled to such proceeds in a prescribed order (and, in the case of a foreign law-governed waterfall, on the assumption that the waterfall is enforceable under the relevant foreign laws).

**7.6 Independent Director. Will a court in Australia give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

As directors are under a duty to act in the best interests of a company and to prevent a company from insolvent trading, any contractual provision or provision in a company's organisational documents prohibiting a director from taking specified actions could be contrary to those duties. As a general principle, Australian courts will not allow directors to act in accordance with such a provision where those actions would otherwise be inconsistent with their duties as directors. In exceptional circumstances, Australian courts have given effect to such provisions where they are subject to a "fiduciary out" allowing a director to act contrary to the contractual provision if the actions of the director would be in breach of any duty owed to the company or unlawful.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Australia, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Australia? Does the answer to the preceding question change if the purchaser does business with other sellers in Australia?**

The NCCPA (see question 1.2) applies if credit is provided in the course of a business of providing credit carried on in Australia or as part of, or incidentally to, any other business of the credit provider carried on in Australia (including where a person engages in conduct that is intended to induce people in Australia to use the goods or services of the person or is likely to have that effect, whether or not the conduct would have that effect in other places as well).

Where credit is provided to consumers, certain persons (e.g. credit providers and lessors and persons exercising their rights or obligations), will require an Australian Credit Licence ("ACL") unless an exemption applies. In the first instance this includes the purchaser where legal title is perfected, as the collection and enforcement of the receivables will be carrying on a business of being credit provider in Australia. An exemption is available to securitisation entities in certain circumstances if specified requirements are met, and other exemptions may be available in particular circumstances.

As noted above, different requirements under the CA will apply if the receivables are margin loans.

In addition to the ACL requirements, an Australian financial services licence ("AFSL") may be required by certain securitisation participants (e.g. trustees and trust managers) under the CA unless an exemption applies. The jurisdictional test in relation to AFSLs is similar to the NCCPA requirements and would unlikely be avoided on the basis that the only business carried on in Australia was in relation to receivables.

Further, the CA also requires a foreign company to be registered with the Australian Securities and Investments Commission if it will "carry on business in Australia", which will depend on a number of factors including whether there is some repetition of commercial activities in Australia.

Where a foreign company has as its sole or principal business in Australia the borrowing or lending of money, or has certain assets in Australia, it may also have to register under data collection and reporting legislation.

---

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

---

A servicer will be exercising the rights and obligations of a credit provider and will therefore require an ACL. This applies whether the servicer is an original or replacement servicer.

Certain Australian states and territories also have separate debt collection legislation which requires debt collectors to be registered or licensed in those jurisdictions.

The servicer may also require an AFSL if the receivables involve financial services regulated under the CA, including insurance or margin loans.

---

**8.3 Data Protection. Does Australia have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

---

The Privacy Act 1988 (Cth) (“PA”) regulates how personal information can be collected, used and disclosed and imposes ongoing standards in relation to the information, including security and access obligations.

The PA only applies to information about individuals, but applies regardless of the consumer’s purpose in entering into the receivable. It extends to personal information about individuals collected in relation to a corporate customer (e.g. directors or employees).

The PA also contains specific requirements that apply to credit information. This information is subject to tighter restrictions on how the information can be collected, used and disclosed.

Bankers also have a duty of secrecy to their customers which arises out of the relationship between banker and customer. This duty applies to both individuals and corporates.

In addition, an equitable duty of confidentiality applies to information of a confidential nature, and unauthorised use or disclosure may constitute a breach of this duty. Contracts may also impose confidentiality obligations and a breach may result in a breach of contract.

---

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Australia? Briefly, what is required?**

---

The NCCPA will apply where a debtor or lessee is a relevant consumer. See further questions 1.2 and 8.1.

If the receivables are sold, the debtor will generally have the same rights against the purchaser as against the original credit provider for failures to comply with the contract disclosure, and certain conduct and fee restrictions under the NCCPA.

Other relevant legislation includes various consumer protections such as:

- provisions making certain unfair contract terms void; and

- prohibitions against unconscionable conduct and misleading and deceptive conduct.

Relevant legislation also contains “linked credit provider” provisions, under which credit providers and lessors can be responsible for the conduct of third parties (e.g. retailers) where the contract or lease has been entered into to finance goods or services offered by those third parties.

---

**8.5 Currency Restrictions. Does Australia have laws restricting the exchange of Australia’s currency for other currencies or the making of payments in Australia’s currency to persons outside the country?**

---

Foreign exchange is controlled by the Reserve Bank of Australia, which may at the direction of the Treasurer direct a person not to buy, borrow, sell, lend or exchange foreign currency in Australia or deal with foreign currency in any other way in Australia.

The approval or authorisation of the Minister for Foreign Affairs is required for certain transactions involving dealings with assets in connection with persons or entities linked to terrorist activities or certain proscribed countries.

Other regulations generally prohibit dealing with certain “designated persons or entities” by directly or indirectly making assets (including shares and securities) available to or for their benefit without a permit, and our anti-money laundering legislation prohibits the entering into of transactions with residents of prescribed foreign countries.

There are no *per se* exchange controls on the transfer of money out of Australia but reporting obligations may apply to certain transfers.

## 9 Taxation

---

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Australia? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

---

Australia imposes withholding tax on, among other things, payments of interest or royalties from Australian residents to foreign resident recipients.

Whether Australian withholding tax will apply to payments, and the rate of withholding, will depend on:

- in the case of interest, whether the payments are interest, or in the nature of or in substitution for interest;
- in the case of royalties, whether the payment is regarded as a royalty for Australian tax (which may include payments for the use of intellectual property and commercial or scientific equipment or information); and
- the country where the recipient is located.

The default rate of interest withholding tax in Australia is 10 per cent and the default rate of royalty withholding tax in Australia is 30 per cent. The rate may be reduced if the recipient is resident in a country with which Australia has a double tax treaty and the treaty

limits the rate of withholding tax. Some treaties reduce the rate to nil in the case of interest withholding tax, and 5 per cent in the case of royalty withholding tax.

For certain underlying receivables (e.g. certain notes), an exemption from interest withholding tax may be available if the underlying issue satisfies the public offer test. There is no equivalent exemption for royalty withholding tax.

For the purposes of Australian interest withholding tax, there is a risk that any discount on a sale of trade receivables may be re-characterised as interest. The tax consequences of deferred payments will depend on the terms of the deferral (e.g. whether any contingencies are involved) and whether any part of the deferred payment is referable to or in substitution for interest.

After 31 December 2016, the U.S. Foreign Account Tax Compliance Act and any Australian legislation implementing an Australia-US intergovernmental agreement may require certain obligors to withhold 30 per cent tax from payments to certain non-compliant sellers or purchasers.

---

### 9.2 Seller Tax Accounting. Does Australia require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

---

The Australian tax law does not require a specific accounting standard to be adopted for securitisation but Australian accounting policies adopted by an entity can impact on the Australian tax treatment of the entity's income and outgoings in some situations. Specific provisions may apply to securitisation vehicles and in respect of financial transactions.

---

### 9.3 Stamp Duty, etc. Does Australia impose stamp duty or other documentary taxes on sales of receivables?

---

In Australia, stamp duty is imposed at the state and territory level on certain kinds of transactions or instruments. These stamp duty laws are not uniform in terms of which transactions or instruments are subject to duty, the rates of duty or the available exemptions and up to eight separate sets of stamp duty laws can apply to a transaction. Generally, the location of the receivables and, in some cases, the related securities will determine which stamp duty laws need to be considered.

Stamp duty issues that can arise in relation to a securitisation include on the transfer of receivables and on the granting of security, although exemptions can apply (for which the exact structure and drafting can be important).

---

### 9.4 Value Added Taxes. Does Australia impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

---

Goods and services tax ("GST") in Australia is imposed at the rate of 10 per cent of the GST-exclusive consideration for a taxable supply. The sale of receivables and related securities is not generally a taxable supply but the supply of collection agent services will generally be a taxable supply on which GST is payable by the supplier. In some circumstances, a securitisation vehicle may be entitled to claim back 75 per cent of the GST payable by the service provider if it is registered for GST.

---

### 9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

---

Australian tax law empowers relevant taxing authorities to collect tax debts (whether or not related to the relevant transaction) and other amounts owing by a recalcitrant taxpayer from third parties. This power generally applies where the third party owes or may later owe money to the taxpayer. In these circumstances, the relevant taxing authority is generally empowered to require the third party to pay the money directly to the taxing authority instead of to the taxpayer.

---

### 9.6 Doing Business. Assuming that the purchaser conducts no other business in Australia, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Australia?

---

The purchaser's potential liability for Australian tax depends on its country of residence for tax purposes.

If the purchaser is resident in a country with which Australia has a double tax treaty, the purchaser should not be liable to Australian tax provided the purchaser does not have a permanent establishment in Australia. This may depend, amongst other things, on the terms of appointment of the seller as its agent in Australia. The terms of the treaty may also provide that particular income is taxable in Australia to a certain extent (e.g. withholding tax on interest).

If the purchaser is resident in a country with which Australia does not have a double tax treaty, the purchaser should only be liable for Australian tax on Australian sourced income. This is determined by reference to the nature of the income and relevant circumstances. In this respect, income that is subject to Australian withholding tax (e.g. interest) is not otherwise assessable in Australia.

### Acknowledgment

The authors acknowledge the significant contribution of Hal Bolitho in relation to all aspects of the PPSA analysis, and the valuable contributions of other members of our Banking & Finance team (including our regulatory team), our Taxation team, our Dispute Resolution team and our Mergers & Acquisitions team who contributed to this chapter.

**Anne-Marie Neagle**

King & Wood Mallesons  
Level 50, Bourke Place  
600 Bourke Street  
Melbourne VIC 3000  
Australia

Tel: +61 3 9643 4258  
Fax: +61 3 9643 5999  
Email: [anne-marie.neagle@au.kwm.com](mailto:anne-marie.neagle@au.kwm.com)  
URL: [www.mallesons.com](http://www.mallesons.com)

Anne-Marie is a Partner in the Melbourne office of King & Wood Mallesons where she specialises in securitisation, hybrid, debt, convertible and structured capital markets transactions, structured finance and derivatives.

Her experience includes advising on the acquisition and securitisation of non-bank lending and leasing receivables, and advising major banks and insurance companies on the issuance of Tier 1 and Tier 2 regulatory capital and on their derivatives programmes.

Anne-Marie is named as a leading lawyer for Capital markets - structured finance and securitisation in the *IFLR 1000* Guide to the World's Leading Financial Law Firms.

**Ian Edmonds-Wilson**

King & Wood Mallesons  
Level 61, Governor Phillip Tower  
1 Farrer Place  
Sydney NSW 2000  
Australia

Tel: +61 2 9296 2520  
Fax: +61 2 9296 3999  
Email: [ian.edmonds-wilson@au.kwm.com](mailto:ian.edmonds-wilson@au.kwm.com)  
URL: [www.mallesons.com](http://www.mallesons.com)

Ian is a Partner in the Sydney office of King & Wood Mallesons where he specialises in structured finance and securitisation transactions.

He acts for a wide range of clients including non-bank originators, investment and commercial banks and trustees in connection with a broad range of asset classes and the raising of debt in multiple jurisdictions (domestic, 144A, Euro).

Ian has been recommended in area of Banking and Finance: Securitisation by the *Chambers Global Guide*, and is "commended for his efforts in securitisation work, while also offering specialist advice on structured finance transactions".

KING & WOOD  
MALLESONS  
金杜律师事务所

With the largest securitisation practice in the region, King & Wood Mallesons remains at the cutting-edge of new product development by financial institutions, investment banks and corporates. We have been involved in almost every landmark securitisation transaction in the Australian market and an increasing number in Asia.

The rate of regulatory and commercial change in the last two years has been remarkable. King & Wood Mallesons' expertise in key disciplines, co-ordinated and collegiate approach to sharing of new information, capacity to efficiently analyse the complex issues in real time and deep relationships with key industry players cements the firm's position as a leader in the Australian securitisation market.

Drawing on our deep understanding of the global capital markets and local conditions, including specialists based in Hong Kong, Beijing and London, and market leading position across the spectrum of capital markets work, our team is advising on some of the most significant transactions in Asia, including the first publicly listed and rated corporate loan securitisation backed by a guarantee from a Chinese export credit agency.

The team was recently named the Structured Finance and Securitisation Team of The Year at the IFRL Asia Awards, 2014.

# Austria

Fellner Wratzfeld & Partners

Markus Fellner



### 1 Receivables Contracts

- 1.1 Formalities.** In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

Austrian law does not require the fulfilment of any special formalities for receivable contracts. Such contracts can be entered into orally, in written form or even be implied based on the conduct of the parties, whereby written contracts are to be recommended for reasons of proof. An invoice alone does not constitute a contract but may evidence its existence. Behaviour of the parties can indicate intent of the parties to conclude a contract, but must show a mutual intent to do so.

- 1.2 Consumer Protections.** Do Austrian laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

There are no specific limit rates of interest on consumer credit, loans or other kinds of receivables stipulated by law. However, there is a general limit resulting from the prohibition against contracts violating public policy. Under Austrian law, under which circumstances high interest rates violate public policy is determined on a case-by-case analysis. Austrian law provides for a right of the creditor to claim interest on late payments. Unless agreed otherwise between the parties, the applicable interest rate stipulated by law applies. The statutory interest rate generally is 4 per cent *per annum* for contracts, and 8 per cent *per annum* over the base rate in case of claims arising out of contracts between companies in business transactions. There are no special legal entitlements allowing consumers to cancel receivables for a specified period of time. The legal venue for claims against consumers is always the competent court of their residence. Moreover, Austrian law has special consumer protection provisions concerning the permissible content of general terms and conditions, which are mandatory in nature.

- 1.3 Government Receivables.** Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

There is no special law regulating the sale or collection of receivables from governmental entities. Such entities, however, are treated differently to private sector firms with regard to non-assignment clauses. Under the Austrian General Civil Code (which includes governmental entities) (ABGB), non-assignment clauses in contracts between a public law corporate body or its subsidiaries on the one hand and an applicant for subsidies on the other are enforceable, whereas such clauses in agreements between private sector firms are not.

### 2 Choice of Law - Receivables Contracts

- 2.1 No Law Specified.** If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Austria that will determine the governing law of the contract?

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 Regulation), which entered into force in all EU Member States, except for Denmark, on 17 December 2009, governs the choice of law in the European Union. It is based upon, and replaces, the Convention on the Law Applicable to Contractual Obligations 1980. Chapter I Article 4 of the Rome I Regulation regulates which law applies in case the parties to an agreement have not agreed on the applicable law. Depending on the kind of contract, different connecting factors are decisive. If a contract is not listed in clause 1 of Article 4, it is governed by the law of the country where the party required to effect the characteristic performance of the contract has its habitual residence, unless it is clear from all the circumstances of the case that the contract is manifestly more closely connected with another country, in which case the law of such country applies. If the applicable law cannot be determined according to the aforementioned principles, as a fall-back rule a contract is governed by the law of the country with which it is most closely connected. If the parties to a receivable contract have not agreed which law applies, since receivable contracts are not listed in clause 1 of Article 4, the contract is governed by the national law according to the principles outlined above. In most cases this is the law of the obligor’s home country.

If the obligor is a customer within the meaning of the Consumer Protection Act (*Konsumentenschutzgesetz*), the choice of the law of a country that is not a European Economic Area Member State in some respects only applies to the extent it is more advantageous to the customer than the law of the European Economic Area Member State which would have applied without this choice of law. The restrictions on the permissible content of general terms and conditions apply to consumer contracts irrespective of the choice of law of the parties to such contract.

**2.2 Base Case. If the seller and the obligor are both resident in Austria, and the transactions giving rise to the receivables and the payment of the receivables take place in Austria, and the seller and the obligor choose the law of Austria to govern the receivables contract, is there any reason why a court in Austria would not give effect to their choice of law?**

No, there is no such reason.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Austria but the obligor is not, or if the obligor is resident in Austria but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Austria give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

In general, the parties to a receivable contract are free to choose the applicable law. This freedom is restricted in cases where all parties to the receivable contract are resident in Austria and Austria is the place of performance. In such constellation, the mandatory provisions of Austrian laws must be applied to a receivable contract. In addition, foreign law will not be recognised to the extent it violates Austrian public policy. Furthermore, for contracts with Austrian consumers, see question 2.1.

**2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Austria?**

Yes, it has been in force since 1 January 1989.

### 3 Choice of Law - Receivables Purchase Agreement

**3.1 Base Case. Does Austrian law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Austria's laws or foreign laws)?**

The receivable contract and the contract out of which the receivables arise can be governed by different laws, irrespective of which law governs the receivables. The enforcement of receivables governed by Austrian law is subject to Austrian law.

**3.2 Example 1: If (a) the seller and the obligor are located in Austria, (b) the receivable is governed by the law of Austria, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Austria to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Austria, will a court in Austria recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?**

A court in Austria will recognise the seller's and the purchaser's choice of the law of Austria irrespective of where the purchaser is resident.

**3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Austria, will a court in Austria recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?**

Since there are no formal requirements for the transfer of receivables, an Austrian court will give effect to the parties' choice of law.

**3.4 Example 3: If (a) the seller is located in Austria but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Austria recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Austria's own sale requirements?**

An Austrian court will recognise such sale as being effective because under Austrian law there are no formal requirements for the transfer of receivables.

**3.5 Example 4: If (a) the obligor is located in Austria but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Austria recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Austria's own sale requirements?**

An Austrian court will recognise such sale as being effective because, under Austrian law, there are no formal requirements for the transfer of receivables.

**3.6 Example 5: If (a) the seller is located in Austria (irrespective of the obligor's location), (b) the receivable is governed by the law of Austria, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Austria recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Austria and any third party creditor or insolvency administrator of any such obligor)?**

An Austrian court will recognise such sale as being effective because, under Austrian law, there are no formal requirements for the transfer of receivables.

## 4 Asset Sales

**4.1 Sale Methods Generally. In Austria what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

There are no special formalities for the sale of receivables. The sole requirement is a mutual agreement between the seller and the purchaser on the sale of the respective receivables. For reasons of proof, this agreement will normally be entered into in written form, which, however, is not mandatory under Austrian law. Furthermore, it is not necessary, for the effectiveness of the sale of the receivables, to inform the obligor of the sale. The obligor, however, is entitled to pay its debt to the seller and thereby discharge the debt until it has received notification of the sale. The customary terminology is that a seller sells receivables under a receivables purchase agreement to a purchaser, whereas in such agreements also the term "assignment" and corresponding terms are customary.

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

As outlined in question 4.1, there are no specific formal requirements for the sale of receivables. A subsequent sale of receivables already sold is impossible under Austrian law since they have already been transferred to the first purchaser. For this reason, an acquisition in good faith generally is not possible although there are exceptions for sham transactions, acceptance bills and cheques. Nevertheless, if the obligor has not been informed of the first valid sale but only of the second invalid sale, it can pay to the second purchaser with a debt discharging effect. In such case, the first purchaser is entitled to a claim based on unjust enrichment against the second purchaser.

**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

In Austria, promissory notes as certificates of debt are not securities and generally only document obligations arising out of a loan.

There are no additional requirements for the assignment of such promissory notes, but they are usually delivered physically in the course of the sale of the receivables.

Mortgage loans are a form of security frequently used in Austria. Mortgages are accessory to the debt they secure and cannot be transferred without it. Mortgages must be registered with the land register to be legally valid. A mortgage can either be registered for a maximum amount or for the actual amount of a debt. In order to be registered with the land register, a mortgage for a maximum amount can only be transferred by notarised written agreement under acceptance of the obligor, which is why a receivable purchase contract, pursuant to which such mortgage shall be transferred, must comply with these formal requirements. Agreements on the transfer of other mortgages do not have to comply with these formal requirements.

Under the Consumer Credit Act (*Verbraucherkreditgesetz*), which implemented EU Directive 2008/48/EG into Austrian law, the consumer has to be informed if the consumer credit agreement itself or claims of the creditor arising therefrom are transferred to a third party, unless the original creditor, with the consent of the assignee, continuously acts as creditor in relation to the consumer. Although this provision is mandatory, its violation does not lead to the invalidity of the assignment.

The additional requirements for the sale and perfection of marketable securities differ depending on the type of security. Each transfer of ownership of securities requires a corresponding agreement between the seller and the purchaser. The transfer of bearer securities additionally requires either handing over of the securities to the purchaser or, as the case may be, instruction to the possessor to hold them in the future for the purchaser. Registered securities are transferred by way of assignment of the rights they certify. Endorsed securities have to be endorsed by the purchaser and transferred to its possession.

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

Under Austrian law, generally sales of receivables need not be notified to obligors nor be approved by them. To the contrary, sales of receivables between entrepreneurs concluded in the course of their business activities are valid even if the receivable contract between the seller and the obligor contains a non-assignment clause (for the exception concerning governmental entities, see question 1.3 above). Breach of a non-assignment clause, however, will subject the assignor to possible damage claims of the obligor. Such damage claims may not be set off against the assigned receivables and an assignee will not be liable only because it knew that a non-assignment clause had been in place between the seller and the obligor.



**4.5 Notice Mechanics.** If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

Under Austrian law, there is no need to give notice to obligors about a sale of receivables (see question 4.4).

**4.6 Restrictions on Assignment - General Interpretation.** Will a restriction in a receivables contract to the effect that “None of the [seller’s] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]” be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says “This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]” (i.e., the restriction does not refer to rights or obligations)?

Restrictions on assignment and sale stipulated in receivable contracts between entrepreneurs and consumers are enforceable and effective even against third parties. Non-assignment clauses in contracts between entrepreneurs concluded in the course of their business activities are not enforceable (see question 4.4).

Under Austrian law the transfer or assignment of a contractual position (including rights and obligations) always requires the consent of the other party.

**4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Austria? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Austria recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Regarding enforceability, see question 4.6 above. A breach of a non-assignment clause in a contract between an entrepreneur and a customer causes invalidity of the assignment unless the obligor consents to the assignment or fails to impose objections based on the non-assignment clause. The seller will be liable to the obligor for the breach of a non-assignment clause and the obligor might withdraw from the contract or claim damages. A claim against the assignee is only possible in case of fraudulent conduct.

**4.8 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells *all* of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

Under Austrian law, it is not necessary to specify the object of sale in detail, but it must be at least definable. For the specification of a concrete object of sale of a receivable purchase agreement, it is, however, advisable to give further details to avoid disputes between the seller and purchaser. Receivables to be sold in one receivable purchase agreement can originate from different kinds of contracts. The assignment of all existing and future receivables or the assignment of all of them with some explicitly mentioned exemptions is possible if the receivables are capable of being identified.

**4.9 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

None of these characteristics will hinder a sale’s perfection but the concrete form of the receivable contract defines whether only the economical ownership or both the economical and the legal ownership are transferred to the purchaser.

**4.10 Continuous Sales of Receivables.** Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes, a seller can sell future receivables (see question 4.7) if the receivables are capable of being identified.

**4.11 Future Receivables.** Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

A seller in principle can sell future receivables that are capable of being identified (see question 4.9). With respect to an obligor’s insolvency, see question 6.5.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

Depending on the type of security, additional formalities for their transfer might be necessary (see question 4.3). To ensure that no security becomes invalid by divergence of ownership of a security from the claim secured by it, receivable purchase agreements usually provide for the assignor to hold the securities in trust for the assignee until they can be legally effectively transferred to the assignee.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

According to the prohibition of impairment stipulated by Austrian law the rights of the obligor may not be limited by a transfer of claims against such obligor. Therefore, set-off rights of the obligor against amounts owed to the seller may be exercised against the purchaser. In the course of an assignment of claims that exist against the obligor, set-off rights of the obligor may only be terminated with such obligor's consent.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Austria to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

Taking a "back-up" security interest is not customary.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Austria, and for such security interest to be perfected?**

See question 5.1.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Austria to grant and perfect a security interest in purchased receivables governed by the laws of Austria and the related security?**

The purchaser and the seller have to enter into an assignment agreement on the granting of a security interest in receivables. To give legal effect to the granting of a security interest, it has to be shown in a way that enables third parties to take notice. This is usually effected via annotation in the purchaser's books, whereas the security interest has to be shown in the respective customer

account (*Kundenkonto*), as well as in the list of open invoices (*Offene-Posten-Liste*).

As long as the concrete amount of future receivables is not known to the purchaser, the remark in its books can be of a general nature, but it has to be individualised after the origination of a specific receivable. To ensure the correct entry in the seller's books, the purchaser should require inspection rights to avoid diverging annotations in the seller's and the purchaser's books. Failure to make correct entries results in the security interest not being perfected.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Austria, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Austria or must additional steps be taken in Austria?**

Unlike contractual undertakings, a transfer *in rem* has to fulfil the formal requirements stipulated by Austrian law. The rules concerning the creation of a pledge, which is a right *in rem*, apply analogously to the granting of a security interest.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

See question 4.3.

**5.6 Trusts. Does Austria recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Yes, Austrian law recognises trusts.

**5.7 Bank Accounts. Does Austria recognise escrow accounts? Can security be taken over a bank account located in Austria? If so, what is the typical method? Would courts in Austria recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Austria?**

Escrow accounts in Austria or in a foreign country are recognised under Austrian law. Security over an Austrian bank account can be taken and is a customary form of collateralisation for banks. Under the general terms and conditions of banks, the borrower grants the bank a lien on all its objects and rights which enter into the bank's possession, which in particular includes the credit on the borrowers' bank account. An Austrian court would recognise a foreign grant of security over an Austrian bank account only if the formalities required by Austrian law are met.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

According to Austrian law, only the balance of the account as at the time of receipt of the third party notice by the garnishee can form

the basis of enforcement. Cash flowing into the bank account after this point in time is not encumbered by the initial pledge of the bank account.

The secured party may only access the account's balance by filing a petition to the court for pay-out of the balance.

---

### 5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

---

The pledge is created with the service of the garnishment order to the garnishee. At this point in time, the owner of the pledged bank account has no access to the funds therein. As of the date of the creation of the pledge, the garnishee is not allowed to pay out money from the pledged account to the owner (*Zahlungsverbot*) and the owner is not allowed to give instructions to the garnishee that interfere with the lien (*Verfügungsverbot*).

---

## 6 Insolvency Laws

---

### 6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Austria's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

---

There is no automatic stay under Austrian insolvency laws. Purchased receivables for which the purchase price has been fully paid and which have already been fully recovered cannot be claimed back by an insolvency administrator. If the receivables have not been sold to the purchaser, but it has a security interest in the receivables, the purchaser has a right of separate satisfaction in case of a seller's insolvency.

### 6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?

---

If contracts are not mutually fulfilled on, or before, the date insolvency proceedings are started, the insolvency administrator can choose between performance or non-performance of the contract. There are special rules for leases and employment contracts.

Certain transactions can be declared void as regards the creditors where a successful challenge is made by the administrator either by legal challenge or defence under the Insolvency Act. The grounds for voidability are:

- Discriminatory intent (*Benachteiligungsabsicht*). This applies if the debtor acted with the intent to create a disadvantage for its creditors and the other contracting party: (i) either knew of this intent (up to ten years preceding the initiation of insolvency proceedings); or (ii) should have known of this intent (up to two years preceding the initiation of insolvency proceedings).
- Squandering of assets (*Vermögensverschleuderung*). A transaction can be challenged if it is seen as squandering the

company's assets. The other party to the transaction must have known or should have known that this was the case (up to one year preceding the initiation of insolvency proceedings).

- Gifts made by the company (*Schenkung*). Gifts made by the company can be challenged if made in the two years before the start of insolvency proceedings.
- Preferential treatment of creditors (*Begünstigungsabsicht*). Acts that favour one creditor over another can be set aside if they occurred in the 60 days before insolvency or after the start of insolvency proceedings.
- Post-insolvency transaction. Transactions taking place after insolvency can be declared void if the creditor knew or should have known about the insolvency (*Kenntnis der Zahlungsunfähigkeit*).

Any disposition of a company's property by the debtor made after bankruptcy proceedings have started is void in proceedings without a debtor in possession since in such cases only the administrator is authorised to represent the debtor. In reorganisation proceedings with a debtor in possession, the debtor is entitled to carry on ordinary business activities, but needs the approval of the reorganisation administrator for extraordinary business activities.

Any impermissible divestment of the debtor's property must be repaid to the insolvency estate. In case this is impossible, damages must be paid.

If third parties have become incontestably entitled to property which is to be restituted, the person, during whose possession the incontestable encumbrance of rights has taken place, must pay damages to the insolvency estate in case such person's acquisition is contestable. In addition, the *bona fide* transferee of a gratuitous conveyance must provide for a restitution of assets only to the extent such transferee is enriched thereby; provided, however, that where such transferee's acquisition of ownership also would be contestable in case of a non-gratuitous acquisition, the entirety of the assets that are the subject of the conveyance must be restituted.

---

### 6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Austria for (a) transactions between unrelated parties, and (b) transactions between related parties?

---

See question 6.2.

---

### 6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

---

See question 6.2.

---

### 6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Austria, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

---

In Austria, both cases are treated in the same manner but the consequences depend on the action taken by the insolvency

administrator, as the administrator has the right to terminate the receivables purchase agreement.

If the administrator terminates the agreement and the receivables come into existence after the commencement of the insolvency proceedings, the purchaser has no valid title to the receivables and such receivables remain in the insolvency estate. If the administrator does not terminate the agreement, the consequences for the receivables are controversial under Austrian legal doctrines. It is not resolved whether the purchaser has the right to single out the receivables from the insolvency estate or whether the purchaser is only regarded as an unsecured creditor of the insolvency estate.

---

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

---

In case the parties have agreed on a limited recourse provision and the creditor has explicitly and irrevocably waived any claims against the debtor exceeding the amounts resulting from the realisation of certain assets of the debtor, the debtor would not be declared insolvent on the grounds that it cannot pay its debts to the creditor as they become due because in such case the creditor would have to realise the collateral and would not have any additional claims against the debtor.

## 7 Special Rules

---

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Austria establishing a legal framework for securitisation transactions? If so, what are the basics?**

---

In Austria, there is no special securitisation law, but there are rules for special securitisation companies (*Verbriefungsspezialgesellschaften*) which can be established solely for the purpose of securitisation.

---

**7.2 Securitisation Entities. Does Austria have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

---

No, special securitisation companies under Austrian law do not differ from other companies except for the restriction that their sole business objective must be the execution of securitisation transactions. The company has to be structured in a way to allow the separation of its own obligations from those of the originator, the legal and beneficial owners of which must be able to pledge and sell the rights connected therewith without restriction.

---

**7.3 Limited-Recourse Clause. Will a court in Austria give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

---

A court in Austria would recognise a contractual provision where the parties agree that the right of recourse shall be limited to the

amounts obtained from the realisation of certain assets of the debtor.

---

**7.4 Non-Petition Clause. Will a court in Austria give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

---

Except for cases of wilful misconduct or gross negligence, a clause prohibiting parties from taking legal actions against the purchaser or another person is legally effective.

---

**7.5 Priority of Payments "Waterfall". Will a court in Austria give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

---

Yes, an Austrian court will give effect to a contractual provision distribution payment to parties in a certain order specified in the contract, even where foreign law is applicable.

---

**7.6 Independent Director. Will a court in Austria give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

---

Such provision could only be effective between the parties but not in relation to third parties generally. A breach of a director's contractual obligation not to commence an insolvency proceeding, however, is justified by mandatory law and therefore does not justify any claim for damages.

## 8 Regulatory Issues

---

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Austria, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Austria? Does the answer to the preceding question change if the purchaser does business with other sellers in Austria?**

---

A purchaser which only collects, enforces and securitises receivables will be qualified as a special securitisation company under Austrian law; such special securitisation companies cannot pursue banking activities, which would require a banking licence or other licences. If the purchaser on the other hand also provides other banking services, it would have to obtain a banking licence and to comply with the provisions concerning financial institutions. The qualification as a special securitisation company solely depends on the purpose and organisation of a company but not on the number of its business partners.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

The business of collecting third parties' receivables requires a business licence for the business of a debt collection agency. Debt collection agencies are not permitted to enforce third party claims before a court or to have claims assigned to them even if such assignment is only undertaken for the purpose of collection of the claims. Collecting agencies are only allowed to collect third party claims arising from claims in tort if the claims are undisputed. The acquisition of receivables from the delivery of goods or provision of services and the assumption of the risk of the collectability of such receivables and in connection therewith the collection of such receivables is a banking business with the meaning of the Banking Act (*Bankwesengesetz*) for which a banking licence is required.

**8.3 Data Protection. Does Austria have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

In Austria, the EU Data Protection Directive (95/46/EC) was implemented in the Data Protection Act 2000 (DSG), according to which the use of personal data of persons and companies is subject to several restrictions aimed at the protection of such data. As a general principle, the use of personal data is only permitted with the explicit consent of the concerned person. However, there is also a weighing of interests of the transferor of data and of the person whose data is affected. This weighing usually allows for the transfer of data in the course of securitisation transactions.

In addition, there is a stricter protection of data of bank customers under bank secrecy provisions stipulated in the Banking Act. As with general data protection, banking secrecy can also be breached if the transferor's interest in disclosing data outweighs the banking customer's non-disclosure interest.

Both the general data protection rules and banking secrecy apply to the purchase of bank loans by special securitisation companies. Because of the weighing of interests, the disclosure of data to the extent absolutely necessary is generally viewed as permitted for the purpose of securitisation.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Austria? Briefly, what is required?**

Under the Consumer Protection Act (*Verbraucherschutzgesetz*) compliance with provisions of consumer protection is the sole responsibility of the seller. Since the validity of a receivable purchase contract may be affected by non-compliance with mandatory provisions of data protection, it is advisable for the purchaser to assure that these provisions are complied with, which typically is part of the representations and warranties package given by the seller.

**8.5 Currency Restrictions. Does Austria have laws restricting the exchange of Austria's currency for other currencies or the making of payments in Austria's currency to persons outside the country?**

Generally, there are no such rules under Austrian law, but the exchange into certain currencies can be restricted by resolutions of the United Nations or the European Union or by decree of the National Bank of Austria (*Österreichische Nationalbank*). Moreover, the exchange of currencies in certain circumstances must be notified to the National Bank of Austria for statistical purposes.

## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Austria? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

Payments on receivables are generally not subject to withholding taxes in Austria irrespective of the due date of the purchase price. In case a portion of the purchase price is allocated to the service of collection of the receivable by the seller such portion might, depending on the individual circumstances, be subject to value added tax, which – in case the buyer is seated abroad – would be payable by the seller according to the reverse charge system.

**9.2 Seller Tax Accounting. Does Austria require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

In Austria, there are no special accounting provisions concerning the securitisation of receivables.

**9.3 Stamp Duty, etc. Does Austria impose stamp duty or other documentary taxes on sales of receivables?**

Austria imposes stamp duty in different amounts on various types of written contracts. On assignment contracts, a stamp duty in the amount of 0.8 per cent of the consideration, is imposed. Assignments between financial institutions and special securitisation companies are exempt from stamp duty. In some other cases (but not all), stamp duty may be able to be avoided by either concluding a contract in the form of an offer and its implied acceptance or, where one of the parties is a foreigner, by signing the document abroad and assuring that it is not brought into Austria.

**9.4 Value Added Taxes. Does Austria impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

In Austria, value added tax is imposed on the sale of goods and provision of services in the amount of 20 per cent of the

consideration. In case of a sale of receivables, the seller undertakes a tax-free turnover with monetary claims. Subject to provision of services by the purchaser to the seller, the purchaser has to pay value added tax, whereas the calculation basis is the difference between the purchase price for the receivables and the economic value of the receivables. This economic value is, in particular in case of the sale of non-performing loans, lower than the book value. The European Court of Justice decided in its decision C-93/10 of 27 October 2011 that the purchaser of receivables does not have to pay any value added tax in case he does not provide services to the seller since in such cases there is no taxable turnover.

If the purchaser is not situated in Austria, the obligation to pay the value added tax is shifted to the seller.

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

All parties to an agreement are liable for the payment of stamp duty, if any. For value added tax, see question 9.4.

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Austria, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Austria?**

The purchase of receivables by a foreigner alone generally would not trigger any tax obligation on the purchaser except for stamp duty, if such arises.



**Markus Fellner**

Fellner Wratzfeld & Partners  
Schottenring 12  
A-1010 Vienna  
Austria

Tel: +43 1 537 70 0  
Fax: +43 1 537 70 70  
Email: markus.fellner@fwp.at  
URL: www.fwp.at

Markus Fellner is a founding partner of Fellner Wratzfeld & Partners. He has extensive experience in high-profile banking and finance, M&A and real estate transactions, as well as complex corporate restructurings and insolvencies. He regularly advises Austrian and international credit institutions on securitisations and refinancings.

**Degrees:** *Doctor Juris*, University of Vienna Law School, 1994; *Magister Juris*, University of Vienna Law School, 1992; *Mag. rer. soc. oec.*, Studies of business administration, University of Economics and Business Administration, 1989.

**Professional Membership:** Austrian Bar Association, International Bar Association.

**Publications:** Markus Fellner is the author of numerous articles mainly on the subject areas of banking and finance, company law, restructuring and insolvency law as well as real estate law. He also regularly speaks at symposiums and seminars.



fellner wratzfeld partner

Fellner Wratzfeld & Partners (fwp) is one of Austria's leading business law firms, combining in-depth legal expertise with well-founded business know-how and a hands-on approach in cutting-edge transactions, often completed under extreme time pressure. The firm's clients include banks and other financial institutions, privately and publicly owned companies and public sector authorities. The firm's expertise covers the full spectrum of industry sectors. The firm is particularly active in representing clients in the following sectors: banking and financing (including securitisations); service providers; infrastructure; oil and gas; as well as industrial manufacturers.

The firm is further unique in that it has a leading practice in both transactional as well as administrative law, which can be ideally combined for project work. Increasingly it has been called upon for forensic work relating to company malfeasance.

The firm's major fields of practice are M&A, Banking and Financing, Restructuring and Insolvency, Real Estate and Litigation/Arbitration. It also has a broad public law practice focusing in particular on public procurement, infrastructure projects (including environmental aspects) and construction law.

# Brazil



Ana Cecília Giorgi Manente



Fernando de Azevedo Peraçoli

## Levy & Salomão Advogados

### 1 Receivables Contracts

- 1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

Contracts with a value greater than ten times the Brazilian monthly minimum wage (approximately US\$4,000) must be undertaken in writing. Although not required, it is advisable that contracts with a smaller value are also evidenced by a written agreement to facilitate their judicial enforcement.

In general, invoices alone are not sufficient to create a debt obligation. However, Brazilian law allows the provider of goods or services to issue a ‘duplicate’ of the invoice (*duplicata*). The *duplicata* together with (i) a receipt issued by the debtor to the effect that a good or service has been received, and (ii) a protest issued in writing by a public notary stating that payment has not been received in due time, form a debt instrument that can be foreclosed in court.

In certain circumstances, the behaviour of the parties is sufficient for a receivable “contract” to be deemed to exist. Generally, these situations are based on the historic relationship between the parties or the standard market practice related to certain types of receivables.

- 1.2 Consumer Protections. Do Brazil’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

Interest rates can be freely contracted when at least one of the parties is a financial institution. That not being the case, there is a limit on interest rates charged by non-financial institutions that is equivalent to the rate charged by the government for late payment of federal taxes.

Brazilian law provides a statutory right to interest on late payments, which corresponds to the rate charged by the government for late payment of federal taxes. Such statutory rate applies unless the agreement or specific law provides otherwise. Penalties for late payments on consumer contracts are capped at 2 per cent.

Consumers may cancel a contract within a period of seven days from its signature or receipt of the good or service, whenever

contracting products and services outside a shop (i.e. by internet or telephone). Upon cancellation, receivables are cancelled and any amount already paid by the consumer must be promptly returned with the corresponding monetary adjustments.

- 1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

The sale of receivables owned by the government or a government agency is a sale of public assets and therefore is subject to specific rules, which provide that government sales must be undertaken through a public auction in accordance with a procedure detailed by law (Federal Law No. 8.666, dated 21 June 1993).

Furthermore, restrictions are imposed by law on the level of indebtedness by the government and its agencies. Because of that, agreements for the sale of government receivables generally avoid provisions by which the seller accepts liability for non-performance of the assigned credits. The collection of receivables owned by the government or by a government agency must be pursued by the relevant entity rather than by the purchaser, via a special collection suit available only to the benefit of public entities. The purchaser may only collect the receivable directly against the obligor if the sale was formalised prior to the commencement of such collection.

In case the receivable is owned by a private seller and the government or government agency is the obligor, then the collection must be pursued in court, subject to the following specific rules, among others: (a) the claimant will not be entitled to attach or seize any obligor’s assets; (b) the final decision against the obligor will not be immediately enforceable; and (c) the judge will issue an order of payment, that will wait in line until all previous orders have been complied with (this could take years).

Since several exceptions to the rules above may apply in relation to government-originated credits, a case-by-case analysis is strongly advised.

### 2 Choice of Law - Receivables Contracts

- 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Brazil that will determine the governing law of the contract?**

According to Article 9 of Decree-Law No. 4.657, dated 4 September 1942, an obligation is governed by the law of the place

of signature of the contract. If the parties are not found in the same country at the moment the contract is formed, the contract is considered formed at the place where the last person to sign the agreement signed it. A different rule applies to contracts formally made of an offer to be accepted via a separate copy of the same instrument by the other party, in which case the law of the place of residence of the offeror prevails. Furthermore, there is jurisprudential authority to the effect that choice of law in violation of such provisions is not acceptable; this view has, however, not been upheld in recent cases and final resolution on this rule is still pending.

**2.2 Base Case. If the seller and the obligor are both resident in Brazil, and the transactions giving rise to the receivables and the payment of the receivables take place in Brazil, and the seller and the obligor choose the law of Brazil to govern the receivables contract, is there any reason why a court in Brazil would not give effect to their choice of law?**

No, Brazilian law will apply in this case.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Brazil but the obligor is not, or if the obligor is resident in Brazil but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Brazil give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

As noted in our answer to question 2.1 above, to the extent that the choice of law does not violate Article 9 of Decree-Law No. 4.657/42, a judicial court in Brazil will give effect to the choice of a foreign law (arbitral tribunals in Brazil, as opposed to judicial courts, are likely to always give effect to said choice).

However, foreign laws, foreign judicial decisions and arbitral awards based on foreign laws (either rendered in Brazil or abroad) will not be enforceable in Brazil in case they violate the Brazilian national sovereignty, public policy or morality.

**2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Brazil?**

The United Nations Convention on the International Sale of Goods will enter into effect in Brazil on 1 April 2014.

### 3 Choice of Law - Receivables Purchase Agreement

**3.1 Base Case. Does Brazilian law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Brazil's laws or foreign laws)?**

No. Brazilian law does not require the sale of receivables to be governed by the same law that governs the receivables.

**3.2 Example 1: If (a) the seller and the obligor are located in Brazil, (b) the receivable is governed by the law of Brazil, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Brazil to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Brazil, will a court in Brazil recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?**

Yes, provided that: (i) the receivables purchase agreement is executed in Brazil; or (ii) the agreement takes the form of a unilateral written offer made by the seller located in Brazil to be accepted via a separate copy of the same written instrument by the purchaser. The agreement shall be registered with the registry of titles and deeds of the domicile of the resident contracting parties to be effective against third parties.

**3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Brazil, will a court in Brazil recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?**

Yes, Brazilian courts will recognise that sale as effective against the seller and other third parties, notwithstanding the compliance with the foreign law. The obligor's domicile is not relevant for the analysis. Regarding effectiveness against third parties please refer to question 3.2 above.

**3.4 Example 3: If (a) the seller is located in Brazil but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Brazil recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Brazil's own sale requirements?**

Yes, but only if both the receivables and the receivables purchase agreement are executed in the obligor's country. As noted in question 2.1 above, to the extent that the choice of law does not violate Article 9 of Decree-Law No. 4.657/42, a judicial court in Brazil will give effect to the choice of a foreign law.

With respect to the enforceability of foreign laws, foreign judicial decisions and arbitral awards based on foreign laws, please refer to question 2.3 above.

Regarding effectiveness against third parties, please refer to question 3.2 above.



**3.5 Example 4:** If (a) the obligor is located in Brazil but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Brazil recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Brazil's own sale requirements?

Yes, Brazilian courts will recognise the foreign sale as long as the receivables purchase agreement has been executed in the seller's country.

**3.6 Example 5:** If (a) the seller is located in Brazil (irrespective of the obligor's location), (b) the receivable is governed by the law of Brazil, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Brazil recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Brazil and any third party creditor or insolvency administrator of any such obligor)?

As noted in our answer to question 2.1 above, to the extent that the choice of law does not violate Article 9 of Decree-Law No. 4.657/42, a judicial court in Brazil will give effect to the choice of a foreign law. In the described situation, the law of the purchaser's country should be acceptable if: (i) the receivables purchase agreement is executed in the purchaser's country; or (ii) the agreement took the form of a unilateral written offer made by the purchaser to be accepted via a separate copy of the same written instrument by the seller.

Regarding effectiveness against third parties, please refer to the registration requirement mentioned in question 3.2 above.

## 4 Asset Sales

**4.1 Sale Methods Generally.** In Brazil what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

The most common method is to enter into an assignment of credit rights agreement, which is normally notified to the obligor and registered with a public notary. These procedures guarantee the effectiveness of the assignment against the obligor and third parties. The customary terminology is "assignment of credit rights" (*contrato de cessão de crédito*).

**4.2 Perfection Generally.** What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

In general, there are no formalities for a sale of receivables documented in writing to be valid between the parties.

Except if otherwise provided under the receivables contract, no approval or authorisation by the obligor is necessary to render the sale valid and enforceable. However, the sale will only be enforceable against the obligor if the latter is notified about it.

The validity and enforceability against third parties depends on the register of the sale agreement with the registry of titles and deeds of the city of domicile of both parties.

**4.3 Perfection for Promissory Notes, etc.** What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

For promissory notes, transfer is made through endorsement – no other formalities of the kind mentioned in question 4.2 being required. For loans, which are normally evidenced by a written agreement other than a negotiable instrument of credit, the formalities are those described in question 4.2 above. Marketable debt securities, if properly registered with the Brazilian securities authorities and systems of clearance, can be freely sold in stock exchanges and/or over-the-counter markets.

**4.4 Obligor Notification or Consent.** Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

Notice to the obligor is required for a sale to be effective against the obligor. Obligor's consent is not required unless otherwise provided in the receivables contract (or if the contract prohibits assignment of the receivables). Notice to the obligor cuts off set-off rights with respect to obligor's and seller's liquid financial obligations with one another.

**4.5 Notice Mechanics.** If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There are no general statutory requirements regarding the form of the notice or how it must be delivered if the receivables agreements may be regarded as debt and the transfer as a transfer of debt only (*cessão de crédito*). If the credit agreement indicates a specific form of notice or if there is any legal requirement for the specific type of credit, the same should be followed. There is no time limit to give notice to obligors. A notice of sale can be delivered after the sale and after insolvency proceedings against the obligor or the seller have commenced and it will only be effective after delivery. The effect is that if a debtor pays the original creditor (seller) prior

to receiving the notice, the payment will be valid and the buyer will have no recourse against the obligor. Also, if the receivables are provided as negotiable instruments, they may be assigned without any prior notice to the obligor, and will be valid against the obligor if the assignment (*endosso*) was performed in accordance with legal requirements for that particular type of negotiable instrument.

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that “None of the [seller’s] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]” be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says “This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]” (i.e., the restriction does not refer to rights or obligations)?**

Yes, the first provision implies that the transfer of receivables may only be made with the express consent of the obligor. The result is slightly different from a provision that subjects the transfer of the agreement itself to the other party’s approval. In that case, a transfer of receivables (but not of any obligations) may be done without the obligor’s consent.

**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Brazil? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Brazil recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

Yes, both restrictions referred in question 4.6 are enforceable in Brazil and there are no exceptions to this rule. If the receivables are sold or assigned in breach of the contractual provision, in general only the seller is liable to the obligor for breach of contract and the purchaser will have no title to claim payment of the receivables from the obligor.

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

There is no statutory provision as to what type of information is necessary on each receivable for the sale to be valid, however, the sale document shall include sufficient information so that the receivables sold can be properly identified. Simply stating that the seller sells all of its receivables, or all of the receivables owing by a certain obligor, is not sufficient identification of the receivables. Usually, it is common to indicate in respect to each receivable: the obligor’s name and taxpayer registration number; the date of execution of the receivables contract; and the invoice number and payment date. Assignment of future receivables usually makes reference to the commercial agreement that will give rise to the

future receivables. Sale of real estate receivables shall also contain a reference to the relevant real estate.

Different kinds of receivables – sharing or not objective characteristics – can be sold under the same sale contract.

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

Brazilian law does not, as a rule, apply a substance-over-form approach in transaction analysis and as a result the parties are free to negotiate the terms of the sale without jeopardising perfection. However, in case the economic characteristics of the transaction completely deprive the sale from having effect, the transaction may be considered ‘simulated’ and thus void. The question is one of fact to be determined by a case-by-case analysis.

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

Yes. This is common in Brazil.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?**

The seller can commit to sell receivables that come into existence after the date of the receivables purchase agreement in an enforceable manner. In fact, this has been recognised by the Brazilian Securities Commission (CVM), which, in 2006, issued regulations providing for a specific type of receivables investment fund (*fundo de investimento em direitos creditórios*, or ‘FIDC’), called ‘non-standardised FIDC’. This new type of fund may securitise receivables which will come into existence after the date of the sale contract. With respect to the identification of future receivables in order to structure the sale in a valid and enforceable manner, please refer to question 4.8 above.

This analysis is altered after the insolvency of the seller is declared, since the administrator is vested with the power to terminate any agreement in case continuing to perform such agreement is not profitable for the bankrupt estate. As a result, in case of bankruptcy there is discretionary room for a decision regarding the continued validity of the assignment agreement.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

Except if provided otherwise in the agreement, the assignment of a

credit includes the related security. As a rule, if there is no prohibition to the sale of the receivables, there shall be no prohibition in transferring the related security. However, it is necessary to notify the guarantor so that he/she/it is aware of the sale of the receivables and that he/she/it is now liable towards the assignee. It may also be necessary to take specific measures to document and register the assignment of the security depending on the nature of the security (e.g., if the collateral is a mortgage of a real estate, assignment must be registered at the relevant real estate registry).

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

In this situation the obligor's set-off rights terminate upon receipt of notice of a sale. Neither the seller nor the purchaser are liable to the obligor for the damages caused by such termination.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Brazil to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

This is not a regular feature in most transactions, but it can be negotiated between the parties. An alternative commonly used in Brazil as a means for the creation of back-up security is the assignment by a seller to the purchaser of a greater number of credits than the final value to be securitised, so that the excess will work as extra collateral.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Brazil, and for such security interest to be perfected?**

A written clause in the agreement assigning the credits is recommended.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Brazil to grant and perfect a security interest in purchased receivables governed by the laws of Brazil and the related security?**

If the security takes the form of a pledge, perfection would require a written agreement registered with a registry of titles and deeds of the place of residence of the pledgor and the pledgee, together with notification to the obligor of pledged receivables. In case the purchaser's assets include real estate or real estate-related receivables, registration of the lien with the competent real estate registry is also required.

Alternatively, the security might take the form of transfer of fiduciary ownership of the receivables. In this case, the purchaser recovers ownership upon payment of the debt. Here again, the lien is perfected through its registration with the registry of titles and deeds of the place of residence of the parties.

A new regulation has been issued to the effect that liens over financial instruments and securities in transactions carried out in the capital markets or Brazilian clearance systems shall be registered in an entity authorised for such purposes by the Central Bank of Brazil or the Brazilian Securities Commission (CVM). However, no entity has yet been authorised.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Brazil, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Brazil or must additional steps be taken in Brazil?**

Brazilian law provides that the applicable law with regard to security interest *in rem* is the law of the domicile of the person in possession of the relevant asset. This rule is more easily adaptable to material assets. As to receivables, given that they are rights, the most sensible view is to consider that they are kept in the place where the creditor benefited by the pledge is resident. As a result, the terms of the collateral should follow the law of the country of such creditor. If they do not, the validity of the collateral might be impaired.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

As general rule, no relevant change applies.

**5.6 Trusts. Does Brazil recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Brazil does not recognise trusts. However, an agreement may be executed in order to obligate the seller to keep collections received as a depositary, being responsible for the safeguarding and maintenance of such assets, for the benefit of the purchaser.

**5.7 Bank Accounts. Does Brazil recognise escrow accounts? Can security be taken over a bank account located in Brazil? If so, what is the typical method? Would courts in Brazil recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Brazil?**

Brazil recognises escrow accounts. Security can be taken over a bank account located in Brazil. In the typical case, security over bank accounts takes the form of a pledge over, or of a transfer of fiduciary ownership of, the credit rights owned by the account holder against the bank.

As mentioned in question 5.4 above, the applicable law with regard to *in rem* collateral is the law of the domicile of the person in possession of the asset. As a result, collateral over a bank account located in Brazil shall follow Brazilian law.

**5.8 Enforcement over Bank Accounts.** If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

The general rule is the absence of limitations. Exceptions are enforcement limited by insolvency laws or similar procedures.

**5.9 Use of Cash Bank Accounts.** If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

The security can be structured to allow – or not allow – the owner of the account to have access to the totality or part of the funds prior to enforcement.

## 6 Insolvency Laws

**6.1 Stay of Action.** If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Brazil's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Brazilian bankruptcy law does not provide for an automatic stay. Notwithstanding, the insolvency official, any creditor or the Public Prosecutor's Office may call the securitisation into question by filing a lawsuit seeking the revocation of the agreement or act (the so-called 'revocation suit'). The plaintiff must prove that the aim of the contracting parties was to defraud creditors (i.e., fraudulent collusion between the seller and the debtor regarding the original debt or between the seller and the purchaser regarding the sale of the receivable) as well as that the bankrupt estate (i.e., formerly the seller) has suffered a loss or damage.

Brazilian bankruptcy law, however, protects *bona fide* investors in the case of credits subsequently securitised through the issue of bonds representing them, setting forth that the validity of the transfer shall not be impaired in case this would damage their rights.

If the purchaser is deemed to be only a secured party rather than the owner of the receivables, then the purchaser will not be able to pursue the receivable against the original obligor or exercise any ownership right over the purchased receivable. The receivable will be part of the seller's estate and collectable by the seller under the applicable insolvency proceeding rules; the purchaser may only collect and enforce the rights it may hold against the seller and in the context of the relevant insolvency proceeding. The sole exception is if the security created in favour of a purchaser is a contractual encumbrance called '*alienação fiduciária em garantia*', which transfers to the purchaser the fiduciary ownership of the receivables.

**6.2 Insolvency Official's Powers.** If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?

The insolvency official is not vested with the power to stop the agreements executed by the seller from having legal effect. The adequate means to prohibit the purchaser's exercise of rights regarding a receivable that is otherwise perfected is to file a revocation suit.

**6.3 Suspect Period (Clawback).** Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Brazil for (a) transactions between unrelated parties, and (b) transactions between related parties?

Under Brazilian law the "suspect" period is referred to as *termo legal* (literally, "legal term"). It is established by the bankruptcy judge in the bankruptcy decree and can retroact up to 90 days before the date of the bankruptcy request, of the judicial reorganisation request, or of the first formal complaint for unpaid debts.

The following acts do not produce effects before the bankrupt estate if they occur within such legal term, irrespectively of the existence of a fraudulent purpose or awareness of the contracting party about the financial and economic situation of the debtor: (i) the prepayment of debts; (ii) payment of matured and enforceable debts in any form other than in the one provided in the relevant contract; and (iii) formalisation of new *in rem* securities in respect to existing debts.

In addition to the above, gratuitous acts and waivers to inheritance or legacy that happened two (2) years before the bankruptcy decree are also ineffective before the bankrupt estate.

There is no difference set forth by law regarding transactions between related and unrelated parties for such purpose.

**6.4 Substantive Consolidation.** Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

According to the Brazilian bankruptcy law, consolidation is not allowed. At most, the transaction may be declared ineffective in case it defrauds creditors.

**6.5 Effect of Proceedings on Future Receivables.** If insolvency proceedings are commenced against the seller in Brazil, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

With relation to (a) and (b), at the very moment insolvency is decreed, the management of the company's assets is transferred to the insolvency official. It will be up to the insolvency official, upon authorisation of the creditors' committee to decide whether to maintain or not the sales agreement.

In case a judicial reorganisation proceeding takes place instead of an insolvency proceeding, the company's activities will not cease. In such hypothesis, the seller's creditors are granted the power to deliberate on the transaction's conditions for the receivables either in case (a) or (b).

---

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

---

The debtor cannot be declared insolvent if it pays its debts in the amount corresponding to the limit set forth in the contract.

---

## 7 Special Rules

---

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Brazil establishing a legal framework for securitisation transactions? If so, what are the basics?**

---

Brazil has laws and regulations specifically providing for securitisation transactions.

The Brazilian Securities Commission (CVM) issued Instruction No. 356, dated 17 December 2001, establishing the legal framework of receivables funds (FIDC) used as conduit entities for securitisation purposes. On 8 December 2006 CVM issued Instruction No. 444 providing for 'non-standardised' FIDC, and allowing the securitisation of receivables that bear higher risks.

Apart from FIDCs, Brazilian law provides for other types of securitisation structures. The securitisation of real estate receivables, for instance, can be undertaken through a 'real estate credit securitisation company' (*companhia securitizadora de créditos imobiliários*), under Federal Law No. 9.514, dated 20 November 1997, or under a 'real estate investment fund' (*fundo de investimento imobiliário*, or 'FII'), under CVM Instruction No. 472, dated 31 October 2008. The securitisation of financial receivables is undertaken through a 'financial credit securitisation company' (*companhia securitizadora de créditos financeiros*), under Resolution No. 2.686, dated 26 January 2000, from the Brazilian National Monetary Council. The securitisation of agribusiness receivables can be made through an 'agribusiness securitisation company' (*companhia securitizadora de direitos creditórios do agronegócio*), which is regulated under Federal Law No. 11.076, dated 30 December 2004.

---

**7.2 Securitisation Entities. Does Brazil have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

---

Brazil has laws and regulations specifically providing for the establishment of special purpose entities for securitisation purposes.

FIDCs and FII funds are investment vehicles for securitisation purposes that take the legal form of a joint-ownership (condominium). These are vehicles without legal personality. The formation of such funds requires an administrator, specially licensed and domiciled in Brazil (typically, a financial institution or

broker-dealer, with a few other possibilities). Any person or legal entity can be an investor in a FII. As to FIDCs, investments are only permitted to qualified investors, as defined by CVM (financial institutions; insurance companies; pension funds; individuals or legal entities with financial investments greater than R\$300,000 who declare in writing their condition of qualified investor; investment funds directed exclusively to qualified investors; and managers of portfolios and consultants in securities authorised by the CVM in relation to their own assets).

Agribusiness, real estate and financial receivables securitisation can be conducted by special purpose Brazilian corporations, the "*companhias securitizadoras*" mentioned in question 7.1. The requirements for the establishment of these corporations do not differ from the ones applicable to any other Brazilian corporation. Shareholders can be of any nationality but non-Brazilian resident ones must appoint a local attorney in fact. Management can be divided in two layers: an optional non-executive supervisory board (minimum of three individuals, resident or not in Brazil); and the executive directors (minimum of two individuals, all domiciled in Brazil).

Certain securitisation securities, such as certificates of real estate receivables (*certificados de recebíveis imobiliários* or 'CRIs') and certificates of agribusiness receivables (*certificados de recebíveis do agronegócio* or 'CRA') can only be issued by the "*companhias securitizadoras*". There is no restriction on the status of a subscriber of CRI or CRA.

---

**7.3 Limited-Recourse Clause. Will a court in Brazil give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

---

Assuming the contract's choice of law is valid, courts in Brazil will give effect to such provision. However, courts in Brazil may limit the reach of this type of contractual provision in the case of fraud perpetrated against creditors.

---

**7.4 Non-Petition Clause. Will a court in Brazil give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

---

According to the Brazilian Constitution no restriction or prohibition can limit one's right to file any claim, petition or suit before any Brazilian court. This is a non-disposable right and will certainly prevail against the non-petition clause, even if such clause is grandfathered by a foreign law governing the relevant agreement.

---

**7.5 Priority of Payments "Waterfall". Will a court in Brazil give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

---

Yes. Waterfall provisions are legal and common in securitisations in Brazil.

**7.6 Independent Director. Will a court in Brazil give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

Ordinarily, a Brazilian court will give effect to contractual provisions or provisions in a party's organisational documents prohibiting the directors from taking specified actions without some other level of corporate approval (i.e.: the affirmative vote of an independent director; or approval by the shareholders), as long as the relevant action is not a duty of the directors under the law.

In respect to actions performed by the directors without the required approval, the company would have recourse against the directors but the Brazilian courts could moderate the effect of the contractual provision to preserve good faith third parties contracting with the company.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Brazil, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Brazil? Does the answer to the preceding question change if the purchaser does business with other sellers in Brazil?**

The purchase, ownership, collection and enforcement of receivables do not require or cause the interested party to do business in Brazil or to obtain any licence in Brazil. The answer is the same in the case that the purchaser does business with other sellers in Brazil.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

To enforce the collection of sold receivables, the seller or the replacement servicer will need to be empowered to act on behalf of the purchaser. Ordinarily, a contractual provision is included in the sale agreement for that purpose.

In case there is pending litigation, once the obligor has been served the initial summons for the collection and enforcement of the receivables, the replacement of the original claimant (either the seller, the purchaser or any third party such as a replacement servicer) by a new claimant will be subject to the obligor's consent.

**8.3 Data Protection. Does Brazil have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

The use of consumer debtor information is restricted by general rules protecting intimacy and private life contained in the Brazilian Constitution as well as banking laws and regulations to the extent that the purchaser is professionally engaged in factoring or similar credit purchase activities. Such rules are not normally construed as

restricting the use of obligor information, but only its unauthorised dissemination. In general, it is lawful to send credit protection agencies information on non-performing contracts or loans. The publication of information on non-compliant obligors, on the other hand, violates the rule.

The breadth of the mentioned rules would justify their application not only to the benefit of consumer obligors, but also to enterprises.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Brazil? Briefly, what is required?**

Not in general, provided that: (i) the purchaser acquired only the receivables (as opposed to being assigned the receivables contract, including obligations towards the obligor); and (ii) the receivables contract does not infringe any law. The sale of the receivables does not change the nature of the same. In view of that, some specific rules to the protection of consumers may affect the receivables (irrespectively of who the purchaser is). An example is the rule that allows prepayment at the initiative of the debtor, against proportional reduction of interest.

**8.5 Currency Restrictions. Does Brazil have laws restricting the exchange of Brazil's currency for other currencies or the making of payments in Brazil's currency to persons outside the country?**

There are presently no important restrictions on the exchange of Brazilian currency or on payments using Brazilian currency to foreigners. In practical terms, the unavailability of accounts in Brazilian currency outside the country is the major obstacle to making payments in Reais outside the country.

## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Brazil? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

There are no withholding taxes when the obligor is an individual. Other than that, payments of receivables can be subject to various withholding taxes in Brazil, depending on the nature of the payments and the condition/residence of the purchaser and the seller. In view of the complexity of Brazilian withholding tax legislation, each transaction should be carefully analysed by a local tax expert.

In the case of a sale of trade receivables at a discount, the discount will be treated as (i) a financial expense/loss (not necessarily interest) to the seller, deductible for corporate income tax purposes in case the seller is a Brazilian legal entity taxed under the real profit regime and the loss meets certain legal requirements, and (ii) a financial revenue (not necessarily interest) to the purchaser; if purchaser is a Brazilian legal entity, this revenue is taxable on a *pro*

*rata* basis as from the date of purchase of the receivables until their maturity, for the purposes of Brazilian corporate taxes on profits and revenues.

Tax legislation usually refers separately to “interest” and “discounts” (as diverse figures), although both are equally taxed as financial and operational revenues or expenses, as the case may be.

As mentioned in question 9.2 below, regulatory rules provide guidelines as to how a securitisation transaction should be treated for accounting purposes, with potential tax repercussions as well. A general guideline is that transactions’ economic essence prevails over their legal form for accounting purposes. As a rule, the seller registers the transaction as a sale of assets at a loss (discount), whereas the purchaser registers the purchase of the asset and the respective gain (discount plus any amount earned in excess of the receivables’ cost of acquisition) along the term of the securitisation.

In principle this form of registering the transaction would also apply to a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, the difference being that such portion of the purchase price would remain as a credit of the seller against the purchaser (and as a debt of the purchaser with the seller) until the purchaser pays it to the seller upon collection of the receivable. However, if in essence the transaction is considered to be a loan and related amounts are considered to be interest in substance, there could be a risk that such amounts be recharacterised in whole or in part as interest. This analysis should be made carefully on a case-by-case basis by local tax and accounting counsel.

Tax on credit transactions (IOF) may also be charged on assignments of receivables in case the seller is co-obliged therefor, except if the purchaser is a non-Brazilian resident. Such IOF is currently charged at a rate of 0.0041 per cent per day plus an additional 0.38 per cent rate on the value of the transaction, limited to 1.88 per cent if the transaction has a defined principal amount. The borrower (i.e., co-obliged seller) is the taxpayer whereas the lender (i.e., purchaser) is liable for charging and collecting the IOF.

---

### **9.2 Seller Tax Accounting. Does Brazil require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

---

There are regulatory rules providing guidelines as to how a securitisation transaction should be treated for accounting purposes, with potential tax repercussions as well. As a general guideline, the transaction’s economic essence is required to prevail over its legal form for accounting purposes. In general, the seller registers the transaction as a sale of assets at a loss (discount), whereas the purchaser registers the purchase of the asset and the respective gain is recognised along the term of the securitisation.

---

### **9.3 Stamp Duty, etc. Does Brazil impose stamp duty or other documentary taxes on sales of receivables?**

---

There are no stamp duty or documentary taxes on the sale of receivables. Nevertheless, it may be necessary or convenient to register certain sales of receivables with public registries in Brazil so that they are enforceable against third parties. Registration duties are imposed on such registrations.

---

### **9.4 Value Added Taxes. Does Brazil impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

---

Sales of goods and certain services are subject to VAT (ICMS),

while other services not subject to VAT and expressly listed by the tax legislation are subject to a municipal service tax (ISS).

Sales of receivables are not subject to value added tax, sales tax or other similar taxes on sales of goods or services.

Fees paid by a Brazilian party to a renderer of collection services resident in Brazil shall be subject to the service tax (ISS), which is charged from the service renderer at a tax rate of up to 5 per cent, depending on the municipality where the services are rendered/performed. In certain cases, the contracting party (purchaser) may be liable for withholding and collecting the ISS. This service tax is not due on services exported to non-Brazilian residents by Brazilian service renderers, as long as the services’ results are verified out of Brazil (i.e. beneficiary of the services located out of Brazil; legislation and current case law are however unclear as to the situations in which service “results” are deemed to take place outside Brazil).

In case the collection agent is an individual resident in Brazil, fees received from the purchaser (if this is a Brazilian legal entity) would be subject to WHT at rates of up to 27.5 per cent. The purchaser would be liable for withholding and collecting this tax.

In the case of collection services rendered to a Brazilian purchaser by a non-Brazilian party, payments remitted abroad would be subject to (i) ISS at a rate of up to 5 per cent, depending on the municipality where the purchaser is located (due by the foreign service provider), (ii) WHT at a rate of 25 per cent (due by the foreign service provider); if a double taxation treaty based on the OCDE model is in effect between Brazil and the country where the non-Brazilian service provider is domiciled, Brazilian WHT may be challenged based on current case law, (iii) social contributions on gross revenues (PIS and COFINS) levied at a combined rate of 9.25 per cent, due by the Brazilian purchaser, and (iv) tax on foreign currency exchange transactions (IOF/*Câmbio*) at a rate of 0.38 per cent, due by the purchaser of foreign currency in remittances made overseas. Due to the form of calculating these taxes, the total effective tax burden can vary between 41 per cent to 59 per cent approximately, depending on whether the burdens of WHT and ISS are transferred to the Brazilian purchaser. In any case, the purchaser would be liable for the collection of these taxes, except for the IOF/*Câmbio*, which is to be withheld and collected by the financial institution that closes the foreign currency exchange transaction.

---

### **9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

---

Tax authorities cannot charge the purchaser for any taxes due and payable by the seller and that have not been paid by the seller. If, however, the seller had tax liabilities and was insolvent when the receivables were sold, the transaction could be invalidated as a fraud against creditors.

---

### **9.6 Doing Business. Assuming that the purchaser conducts no other business in Brazil, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Brazil?**

---

The mere ownership of the receivables, the acquisition of the same by an agreement executed out of Brazil, and the appointment of a

collection agent does not render the purchaser resident out of Brazil subject to Brazilian corporate taxation.

On the other hand, Brazilian tax law provides that the maintenance of an agent or representative in Brazil with powers to negotiate contracts and bind their foreign principal can be characterised as a permanent establishment and therefore may subject the foreign entity's income to Brazilian corporate taxation. In view of this, maintenance of an agent or representative in Brazil which purchases receivables contractually binding the foreign entity may trigger Brazilian corporate taxation of the foreign entity's income under the same rules applicable to local entities (the actual tax burden may depend on particular circumstances).

Even if not considered "doing business" in Brazil, the purchaser may be subject to Brazilian taxation on specific situations/transactions (i.e., taxes withheld at source, foreign currency exchange tax, etc.).

Our considerations above do not include Brazilian taxation potentially applicable to payments made by the purchaser to potential investors under any securities or debt instruments issued by the purchaser in order to fund the acquisition of the receivables.

### Note

The information above is a general overview and not an exhaustive explanation on the matters discussed therein. It does not constitute legal advice, which should be sought specifically with regard to any matter on a case-by-case basis.



#### Ana Cecília Giorgi Manente

Levy & Salomão Advogados  
Av. Brigadeiro Faria Lima, 2601 - 12th floor  
01452-924 - São Paulo - SP  
Brazil

Tel: +55 11 3555 5115  
Fax: +55 11 3555 5048  
Email: [amanente@levysalomao.com.br](mailto:amanente@levysalomao.com.br)  
URL: [www.levysalomao.com.br](http://www.levysalomao.com.br)

Ana Cecília Manente is a partner of Levy & Salomão Advogados. Her practice concentrates on managed funds, foreign investment, and M&A deals. Ana also has extensive experience with structured finance, lending and venture capital, as well as securities and general corporate matters. Ana works regularly with both foreign and Brazilian private equity investors and hedge funds on fund formation and administration and investment structuring, and she serves as principal Brazilian counsel to many large international corporations doing business in Brazil. Ana advises clients on entity formation, including: for joint ventures and M&A; corporate governance and regulatory compliance; real estate transactions; as well as leveraged transactions and access to capital markets, such as IPOs and bond issuances. Ana holds a Bachelor of Laws degree from the University of São Paulo and a specialist degree in International Finance from the Foundation Institute of Economic Research of the University of São Paulo - FIPE/USP.



#### Fernando de Azevedo Peraçoli

Levy & Salomão Advogados  
Av. Brigadeiro Faria Lima, 2601 - 12th floor  
01452-924 - São Paulo - SP  
Brazil

Tel: +55 11 3555 5127  
Fax: +55 11 3555 5048  
Email: [fperacoli@levysalomao.com.br](mailto:fperacoli@levysalomao.com.br)  
URL: [www.levysalomao.com.br](http://www.levysalomao.com.br)

Fernando is a senior associate in Levy & Salomão's Corporate & Securities group, where his practice concentrates on public and private offerings, finance and secured transactions. He has significant experience with fund formation and private equity matters, project finance, bond issuances and M&A transactions. Fernando works regularly with both international and Brazilian investment funds, corporations, as well as banks and other financial service providers. Fernando has also represented clients in administrative proceedings before Brazil's Central Bank and Securities Commission (CVM). Fernando holds a Bachelor of Laws degree from Universidade Mackenzie, a specialist degree in Tax Law from Pontifícia Universidade Católica de São Paulo, a specialist degree in Economics and Corporate Law from Fundação Getúlio Vargas and a LL.M. from Georgetown University Law Center.

## LEVY & SALOMÃO ADVOGADOS

Levy & Salomão Advogados is a full-service law firm founded in 1989 to serve the needs of both Brazilian and foreign corporate clients. Our offices are located in São Paulo, Rio de Janeiro and Brasília. The firm handles demanding and complex cases and clients are afforded direct personal attention of experienced and renowned partners. Our lawyers are known for their strong analytical skills, their creativity in devising legal solutions, and their team-based approach to serving clients. Levy & Salomão attorneys combine solid academic backgrounds with substantial experience not only in the practice of law, but also in finance, capital markets, international business and accounting, and in government. Many of our professionals have previously worked for foreign law firms in the US and in Europe, and several are licensed to practice in foreign jurisdictions. Our client base is comprised primarily of transnational corporations and Brazilian corporate groups that require legal counsel on diverse aspects of law.



# Canada



Michael K. Feldman



Jim Hong

Torys LLP

## 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

- (a) Certain consumer contracts or sales that are subject to the sale of goods legislation (sales involving personal property other than receivables and money) must be in writing in order to be enforceable.
- (b) Invoices alone are sufficient to create a receivable, subject to the need to comply with consumer protection legislation, where applicable.
- (c) A contract can be found to exist based on the behaviour of the parties and a written contract is not necessary to create a receivable, but would be helpful from an evidentiary perspective in case of a dispute.

**1.2 Consumer Protections. Do Canada’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

- (a) The *Criminal Code* (Canada) makes it a criminal offence, subject to criminal sanctions, to charge interest at a rate greater than 60 per cent *per annum*. Interest is broadly defined to include fees and other amounts payable by the borrower to the lender and is determined on the basis of the actual annualised return realised by the lender, other than in cases of voluntary prepayments by the borrower. In commercial cases, courts have generally reduced the fees and other returns in excess of 60 per cent *per annum* to fall within the *Criminal Code* limits, rather than striking down all interest and fees altogether if there is a violation, where the commercial agreement so provides.

The *Interest Act* (Canada) prohibits charging an increased rate of interest on arrears of principal or interest that is secured by a real property mortgage.

Certain provinces also have consumer protection legislation that applies to lending transactions giving courts the ability to reduce the excessive cost of borrowing charges. Québec legislation provides that, in such a case, the underlying contract may be terminated or the borrowing costs voided.

There is also case law in common law provinces to the effect that a higher rate of interest after default may be an unenforceable penalty.

- (b) There is generally no statutory right to interest on late payments in the common law provinces. The ability to charge interest must be supported by a contract. In Québec, there may, in certain circumstances, be a statutory right to interest for late payments.
- (c) All provinces provide a cooling off period for direct sales contracts (contracts that are negotiated other than at the seller’s place of business). Certain provinces provide cooling off periods for various other types of consumer contracts as well.
- (d) There is a wide array of ‘cost of borrowing’ laws in Canada. The failure to comply with cost of borrowing disclosure may lead to an inability to enforce the resulting receivable. In addition, class action laws have been liberalised in Canada in the past decade to make it easier for representative plaintiffs to assert claims on behalf of a class of affected consumers.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

Generally, receivables due from either the federal or a provincial government are not assignable unless certain procedural steps are taken under the *Financial Administration Act* (Canada) or analogous applicable provincial legislation. Receivables due from government agencies may, or may not, be assignable and assignability must be determined on a case-by-case basis. Certain tax rebates may be assigned under the *Tax Rebate Discounting Act* (Canada) or analogous applicable provincial legislation if prescribed procedures are followed.

## 2 Choice of Law - Receivables Contracts

**2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Canada that will determine the governing law of the contract?**

Canadian courts would apply principles of private international law in determining the law of the contract. Factors to be considered include the domicile, residence, nationality or jurisdiction of incorporation of the parties, the place where the contract was concluded and the place where delivery of goods or services is to be performed.

As a practical matter, foreign law must be proven by expert evidence in Canadian courts. Therefore, if an action on a contract without an express choice of law is brought in a Canadian court, and the court assumes jurisdiction over the matter due to a sufficient connection with the matter, it is likely that the court would be willing to interpret the contract under the laws of the forum unless the issue was disputed and expert evidence of the foreign law was introduced.

**2.2 Base Case. If the seller and the obligor are both resident in Canada, and the transactions giving rise to the receivables and the payment of the receivables take place in Canada, and the seller and the obligor choose the law of Canada to govern the receivables contract, is there any reason why a court in Canada would not give effect to their choice of law?**

It should be noted that matters of contract law fall under provincial jurisdiction. Therefore, on the basis that this question can be read as relating to a particular province of Canada, the answer is that the court would give effect to a choice of the law of that province, subject to the qualifications listed under question 2.3.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Canada but the obligor is not, or if the obligor is resident in Canada but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Canada give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

A court would recognise the choice of foreign law in an agreement provided that the parties' choice of foreign law was *bona fide* and there was no reason for avoiding the choice on the grounds of public policy. Notwithstanding the parties' choice of law, a court:

- will not take judicial notice of the provisions of the foreign law but will apply such provisions only if they are pleaded and proven by expert testimony;
- will apply the law of the forum that would be characterised as procedural;
- will apply provisions of the law of the forum that have overriding effect (for example, certain enforcement provisions of the *Personal Property Security Act* (PPSA) in the common law jurisdictions would take priority over inconsistent remedy provisions in a security agreement governed by a foreign law) or, in Québec, that are applicable by reason of their particular object;
- will not apply any foreign law if such application would be characterised as a direct or indirect enforcement of a foreign revenue, expropriatory or penal law or if its application would be contrary to public policy of the forum; and
- 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.

**2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Canada?**

Yes, it is.

### 3 Choice of Law - Receivables Purchase Agreement

**3.1 Base Case. Does Canada's law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Canada's laws or foreign laws)?**

No. The parties to the receivables purchase agreement would be free to choose a different law than that governing the receivables themselves. See question 2.3.

**3.2 Example 1: If (a) the seller and the obligor are located in Canada, (b) the receivable is governed by the law of Canada, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Canada to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Canada, will a court in Canada recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?**

On the basis that this question can be read as relating to a particular province of Canada (see question 2.2) and subject to compliance with perfection requirements discussed under questions 4.2 and 4.4, a court in a province of Canada would recognise the effectiveness of the sale.

**3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Canada, will a court in Canada recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?**

The answer would be the same as for question 3.2, except that the effectiveness of the assignment against the foreign obligor would be governed by the law of the jurisdiction where the obligor was located, not as described in question 4.4.

**3.4 Example 3: If (a) the seller is located in Canada but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Canada recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Canada's own sale requirements?**

The sale would be recognised so long as the seller remains solvent, subject to the qualifications referred to in question 2.3. As a practical matter, in securitisations involving a Canadian seller, a true sale legal opinion is usually required and Canadian counsel would not be able to opine on the enforceability or the effect of a receivables purchase agreement governed by a foreign law. Also, in a bankruptcy proceeding in a Canadian court affecting the seller, it is possible that the court might recharacterise a sale under a foreign

law as constituting a secured loan under applicable Canadian law if the receivables purchase agreement would not also constitute a sale under applicable Canadian law.

**3.5 Example 4: If (a) the obligor is located in Canada but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Canada recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Canada's own sale requirements?**

A court would recognise the sale under the law of the seller's country, but this would not obviate the need to comply with the requirements set out in question 4.4 for the sale to be effective against obligors in Canada.

**3.6 Example 5: If (a) the seller is located in Canada (irrespective of the obligor's location), (b) the receivable is governed by the law of Canada, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Canada recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Canada and any third party creditor or insolvency administrator of any such obligor)?**

The answer here is the same as for question 3.4, with the added requirement to comply with the procedures set out in question 4.4 for the sale to be effective against obligors in Canada.

## 4 Asset Sales

**4.1 Sale Methods Generally. In Canada what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

Typically, the sale would be effected pursuant to a receivables purchase agreement. The terms of the receivables purchase agreement would depend upon whether the commercial arrangement is a factoring (financing), a whole loan sale (where the seller retains no residual interest in the receivables sold) or a version typically used in a securitisation (where the seller is entitled to a deferred purchase price reflecting a residual interest in the receivables). There is no significance to the choice of terminology among sale, transfer or assignment.

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

In each of the common law provinces (all provinces other than Québec), perfection is governed by that province's PPSA. Under

the PPSA, an absolute transfer of receivables is deemed to be a security interest. In order for the transferee to take priority in those receivables as against third parties (such as subsequent good faith purchasers for value), the deemed security interest must be perfected, usually by registering a financing statement in the PPSA registry in the province where the assignor is located for the purposes of the PPSA.

In Québec, an assignment of receivables could be perfected by registration only if the receivables transferred constitute a "universality of claims". If the receivables do not constitute a universality of claims, the assignment may be perfected with respect to Québec obligors only by means of actual notice of the assignment to such obligors. There is considerable uncertainty about what constitutes a universality, but it is generally accepted that a sale of all receivables of a particular type generated by the seller between two specified dates would constitute a universality of claims. It should be noted that the creation of a universality in this way prevents the random selection of Québec receivables for inclusion in a segregated pool of Canadian receivables; rather, the Québec receivables would normally be selected so as to constitute a universality of claims generated between two specified dates.

**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

A transfer of promissory notes is governed by the *Bills of Exchange Act* (Canada) which deals with the rights of holders in due course of a bill, note or cheque. While perfection of an assignment of promissory notes is still governed by applicable provincial PPSAs (that is, in order to perfect the assignment as against third parties, either registration or possession is required), most PPSAs expressly provide that the rights of holders in due course are not affected by provincial PPSAs. As a practical matter, in order to ensure that the purchaser of a promissory note has priority over other claimants (to ensure no-one else can become a holder in due course), it will be necessary for the purchaser, or a custodian acting for the purchaser, to take and maintain possession or control.

Most provinces of Canada have enacted Securities Transfers Acts (STAs) that deal comprehensively with the transfer and holding of securities and interests in securities. This legislation is modelled after article 8 of the U.S. Uniform Commercial Code.

In each of the common law provinces, an assignment of interests in real property (such as mortgages) is perfected by registering the assignment in the applicable land titles or land registry office. Usually, sellers anticipating the sale of mortgages by securitisation will arrange for their mortgages to be originated in the name of a licensed trust company as nominee, bare trustee and custodian for the benefit of the beneficial owner in order to obviate the need to reassign the mortgages for securitisation. When mortgages are not registered in the name of a custodian or nominee, registration of assignments is typically not made at the closing of the securitisation transaction where the assignor has an investment grade credit rating; instead, the assignor will deliver a power of attorney in registrable form, which may be used by the transferee to register mortgage assignments at a later date. Since these powers of attorney are coupled with an interest in the related mortgages, such powers of attorney would survive the bankruptcy of the grantor of the power (the assignor).

In Québec, claims under a mortgage (a loan secured by an immovable hypothec) constitute personal (movable) property and perfection is obtained in the same manner as for other receivables: that is, by registration at the personal property security register (and not the land

registry office) in the case of the universality of claims, or else by providing evidence of the assignment to the obligor. The assignment of the mortgage (hypothec) resulting from the assignment of the claims should be registered at the land registry office, however, failure to comply with said requirement would not render the sale ineffective against a trustee in case of bankruptcy of the seller.

There are no statutory provisions providing that an assignment of consumer loans be treated differently than other loans.

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

In order for an assignment of a receivable to be effective against the obligor, the obligor must receive notice of the assignment. Until the obligor receives notice, it may discharge its obligations by making payment to the seller and also retain the benefit of all defences that may be asserted against the seller. Therefore, even where there is no need to notify obligors in order for the assignment to be effective, the benefit of providing notification is to cut off the benefit of defences that could arise in the future.

In order for an assignment to be effective against the seller and its creditors, it is generally not necessary to notify obligors so long as the assignment is perfected by registration. The only exception is for obligors residing in Québec, where the assignment does not constitute a universality (see question 4.2).

A receivable that arises pursuant to a contract that does not expressly prohibit assignment is an assignable receivable (except where the obligor is the federal or a provincial government or certain agencies thereof). A receivable from a government obligor is not assignable unless specified procedures are followed under the *Financial Administration Act* (Canada) or applicable analogous provincial legislation.

Contractual restrictions on the assignment of receivables are not binding on third party assignees; hence an assignment of "non-assignable" receivables may be perfected (subject to the rights of an unnotified obligor discussed under question 4.6); however, an assignment of an undivided interest in a receivable (rather than the entire receivable) would remain subject to contractual restrictions.

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

There are no mandated requirements regarding the form of notice or delivery mechanism; however, the onus of proving delivery will

rest upon the party asserting delivery was made. Obligor may be notified of the assignment of their receivables at any time; however, if the seller files for protection under the *Companies' Creditors Arrangement Act* (Canada) (CCAA) or the *Bankruptcy and Insolvency Act* (Canada) (BIA), a judicial stay of proceedings would likely prohibit the purchaser from notifying obligors of the assignment of their receivables without first obtaining a court order permitting such notice to be given.

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?**

An assignment of a non-assignable receivable (as opposed to an assignment of an undivided interest in the receivable) is binding as between the seller and purchaser; however, the obligor thereunder will be entitled to fully discharge its obligations by making a payment to the seller, and therefore such an assignment would still be subject to the seller's insolvency risk.

**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Canada? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Canada recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

As noted in question 4.6, the assignment would be effective as between the seller and the purchaser. The seller could be liable for damages due to breach of contract and unless there was a waiver of set-off or defences by the obligor, the obligor may set off these damages against the receivable.

The purchaser could be liable to the obligor for the tort of inducing breach of contract.

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

It is not necessary for the sale document to identify each specific receivable; however, it must contain a description of the receivables being sold sufficient to allow them to be identified as belonging to the class of receivables sold. This may be satisfied by a sale of all of a seller's receivables, or all receivables sharing objective characteristics, or all receivables of the seller other than those owing from specifically identified obligors.

If a sale is of less than all of the receivables of a particular type, then the existence of shared objective characteristics that would permit identification of receivables as either being sold or not sold would affect the characterisation of such receivables as a universality in Québec. See question 4.2.

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

There is a risk of a court recharacterising a sale of receivables as a secured loan. True sale legal opinions are typically delivered in Canadian securitisation transactions. The most important factor in determining whether there has been a true sale is the intention of the parties, as evidenced by the documents, communications and conduct of the parties. The most important indication of the intention that an arrangement is a secured loan is the existence of a right of the seller to require that the receivables sold be reassigned to it.

According to the only reported judicial decision in Canada that considered the issue of the recharacterisation of a sale in a securitisation context, the court listed the following factors, in addition to the intention of the parties, to be considered in determining whether a transaction constitutes a true sale:

- (a) the transfer of ownership risk and the level of recourse;
- (b) the ability to identify the assets sold;
- (c) the ability to calculate the purchase price;
- (d) whether the return to the purchaser will be more than its initial investment and a calculated yield on such investment;
- (e) the right of the seller to retain surplus collections;
- (f) a right of redemption by the seller;
- (g) the responsibilities for collection of the receivables; and
- (h) the ability of the seller to extinguish the purchaser's rights from sources other than the collection of the receivables.

Of these factors, it is likely that the only one that is determinative of the issue by itself is the presence of a right of redemption. In determining whether there is a right of redemption, the court merely looked to whether there was a contractual right of the seller to repurchase or redeem the purchased receivables and did not infer that there was one on the basis of an economic analysis of the transaction.

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

Yes, they can.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?**

Yes. However, the sale only occurs when the receivables come into existence.

When receivables arise after the seller's insolvency, the seller or its Insolvency Official may treat the sale of future receivables as an executory contract and disclaim such contract. Also see question 6.5.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

Security interests securing the receivables transferred to the purchaser are assigned together with the receivables. Under the PPSA, the registration of an assignment of a security interest by the secured party is optional; such registration is not necessary in order to maintain perfection of the original security interest. Since the originator is also normally appointed as the servicer of the receivables, it is rare to effect these registrations at the time of a securitisation. However, if a replacement servicer is appointed, such registrations would be effected by, or on behalf of, the purchaser at such time. Under the Québec Civil Code, the need to register an assignment of a security interest or other rights depends on the type of security interest or other rights involved.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

Notice of assignment will not terminate a right of set-off that accrued prior to receipt of the notice. Notice of assignment will also not terminate a right of set-off that accrues after receipt of the notice if the set-off right arises out of the same or closely interrelated contracts. As for liability of the seller or purchaser, refer to question 4.7.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Canada to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

No. That may be interpreted as contrary to the intent of the parties to treat the transaction as a sale. In any event, as long as the assignment is perfected as an assignment, if it is recharacterised by a court as a secured financing, the perfected assignment will also

constitute perfection of the security interest in common law provinces.

Under Québec law, the likelihood of recharacterisation is low, as the assignment of claims as security is no longer recognised. If the transaction is recharacterised, the sale would likely not constitute a movable hypothec without delivery.

---

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Canada, and for such security interest to be perfected?**

---

This is not applicable in common law provinces.

To the extent that Québec laws apply to the validity and perfection of such security, appropriate charging language and a charging amount in Canadian dollars would need to be included in the documentation so as to constitute a hypothec. A registration of the hypothec would also be necessary. Additional formalities for the granting of the hypothec might have to be followed if the secured obligations constitute titles of indebtedness such as notes.

---

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Canada to grant and perfect a security interest in purchased receivables governed by the laws of Canada and the related security?**

---

The purchaser would have to grant security by means of a written agreement, which (subject to question 2.3) need not be governed by the laws of a Canadian province. A security interest in receivables would attach when:

- (a) value is given by the lender;
- (b) the debtor has rights in the receivables or the power to transfer rights in the receivables to the lender; and
- (c) the debtor has signed a security agreement that contains a description of the receivables sufficient to enable them to be identified.

Where the purchaser funds the purchase of receivables by issuing notes, it would ordinarily enter into a trust indenture with an indenture trustee acting for the noteholders and other secured creditors. The trust indenture would include the granting of a security interest over the receivables.

In each of the above two cases, perfection would be achieved by registration under the applicable PPSA in common law provinces.

To the extent that Québec law applies, it would also be necessary for the purchaser to enter into a hypothec.

---

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Canada, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Canada or must additional steps be taken in Canada?**

---

It will be recognised. Where the purchaser is located (or domiciled under Québec law) outside Canada, no additional steps are required. If the purchaser is located in a Canadian province, it would be necessary to perfect the security interest by registration. If the purchaser is domiciled in Québec, a hypothec will be required.

---

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

---

Please refer to question 4.3.

---

**5.6 Trusts. Does Canada recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

---

These types of trusts are recognised in common law provinces, not Québec. However, a trust cannot "deem" collections to be held separate and apart from the seller's own assets if, in fact, they are commingled with the seller's assets such that they may not be separately identified.

In Québec, a similar result would be achieved by appointing the seller as agent (mandatory) of the purchaser.

---

**5.7 Bank Accounts. Does Canada recognise escrow accounts? Can security be taken over a bank account located in Canada? If so, what is the typical method? Would courts in Canada recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Canada?**

---

Security can be granted over escrow accounts. The means for taking security depends upon the type of account. For simple bank accounts, perfection can be achieved by registration under the applicable PPSA or by obtaining a hypothec over the claim resulting from such bank account if the holder is domiciled in Québec. For securities accounts, it is necessary to take control over these accounts under the applicable STA in those provinces that have enacted STAs.

Courts in Canada would recognise a foreign law grant of security subject to provincial private international law rules governing the validity of security interests; however, procedural aspects of enforcing security would be governed by the law of the province where the account was located.

---

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

---

Where security over a bank account is properly enforced and is not subject to a stay of proceedings in connection with an insolvency filing by the grantor of security and is not subject to prior ranking liens or claims and the bank has agreed to do so, the bank will recognise the secured party as the person in control of the account and all proceeds flowing into it.

---

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

---

Yes, they can.

## 6 Insolvency Laws

**6.1 Stay of Action.** If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Canada's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Under the restructuring provisions of the BIA, a stay of proceedings is automatic for a period of 30 days and may be renewed by court order for further 30-day periods (up to a maximum period of six months). Under the CCAA, an application to restructure normally includes an application for a stay order of unlimited duration which is normally granted by the court.

If there has been a true sale of receivables and the seller has been replaced as servicer by a replacement servicer and all obligors have been notified of the assignment prior to the filing under an insolvency proceeding, the stay would not affect the collection of such receivables. However, the stay could prevent a replacement servicer from being appointed or obligors from being notified until a court determines that the transaction constituted a sale of receivables rather than a secured financing.

If the sale was not a true sale and the purchaser is deemed to only be a secured creditor, the stay of proceedings would prohibit the purchaser from enforcing its rights as a secured creditor unless leave is obtained from the court.

**6.2 Insolvency Official's Powers.** If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?

Although a stay order under the CCAA is not automatic, it is almost always included as part of the application by the debtor company to initiate restructuring proceedings under that Act.

**6.3 Suspect Period (Clawback).** Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Canada for (a) transactions between unrelated parties, and (b) transactions between related parties?

Numerous statutes may be relevant in connection with the insolvency of the seller (collectively: Insolvency Statutes), including the BIA, the CCAA, the *Winding-up and Restructuring Act* (Canada) and various provincial fraudulent preference and fraudulent conveyance statutes. Under the Insolvency Statutes, certain transactions by an originator may be overridden or set aside in certain circumstances, including the following:

- a transfer of property made with the intention of defeating or defrauding creditors or others of their claims against the seller;
- a transaction that is entered into by an insolvent seller (or a seller that knows that it is on the verge of insolvency):

- with the intent to defeat or prejudice its creditors;
- with a creditor with the intent to give that creditor preference over the other creditors of the seller; or
- with a creditor and that has the effect of giving that creditor a preference over other creditors of the seller;
- a gratuitous conveyance made within three months immediately preceding the commencement of a winding-up proceeding;
- a contract, whereby creditors are injured or delayed, made by a seller who is unable to meet its engagements with a person who knows of that inability or who has probable cause for believing that such inability exists;
- a conveyance for consideration, whereby creditors are injured or obstructed, made by a seller who is unable to meet its engagements with a person ignorant of that inability and before that inability has become public, but within 30 days before the commencement of a winding-up proceeding; and
- a sale, deposit, pledge or transfer of any property by a seller in contemplation of insolvency by way of security for payment to any creditor whereby that creditor obtains, or will obtain, an unjust preference over other creditors.

The time periods noted above relate to third party dealings; such review periods are extended if the seller and purchaser are related parties. In addition, under the transfers at undervalue provisions of the BIA and CCAA, a court may review a disposition of property for which the consideration received by the seller is conspicuously less than the fair market value of the receivables sold by the seller who becomes an insolvent person or bankrupt.

Bulk sales legislation applies in certain provinces if there is a sale of tangible assets (such as leased autos or equipment) out of the ordinary course of business. Failure to comply with applicable bulk sales legislation could make the purchaser responsible for losses suffered by the creditors of the originator (up to the value of the transferred assets).

**6.4 Substantive Consolidation.** Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

There are no express provisions for substantive consolidation under the Insolvency Statutes. Instead, the jurisdiction to order substantive consolidation rests under the general equitable jurisdiction of the court in insolvency proceedings. There are only a small number of Canadian court decisions with reasons for judgment dealing with substantive consolidation. Canadian courts have generally adopted the "balancing of prejudice" test from U.S. court decisions, whereby the court asks whether the creditors of the insolvent person will suffer greater prejudice in the absence of consolidation than the debtor (and any objecting creditors) will suffer from its imposition. Factors commonly referred to in determining the balancing of interests include the following:

- difficulty in segregating assets;
- presence of consolidated financial statements;
- profitability of consolidation at a single location;
- commingling of assets and business functions;
- unity of interests in ownerships;
- existence of inter-corporate loan guarantees; and
- transfer of assets without observance of corporate formalities.

Since substantive consolidation is an equitable remedy, the risk that it could be applied cannot be eliminated; however, to reduce the risk

of substantive consolidation, a number of steps can be taken, including the following:

- (a) the special purpose purchaser can be established as an “orphan” trust legally under the control of an arm’s-length trustee, with no beneficiary having a right to terminate the trust;
- (b) if an intermediate special purpose entity that is wholly owned by the seller (to which the receivables would be sold before being sold again to the purchaser) is used, it can be required to have an independent director who would be required to approve any fundamental change (such as amalgamation, winding-up or sale of substantial assets of the intermediate special purpose entity); and
- (c) the intermediate special purpose entity or the special purpose purchaser should be operationally separate from the seller through the following means:
  - it can have its own bank accounts to pay its liabilities;
  - it can have its own financial statements prepared;
  - its liabilities should not be guaranteed by the seller; and
  - it should hold itself out to third parties as a separate entity distinct from the seller.

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Canada, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

Both would be executory contracts that could be disclaimed by an Insolvency Official. Also, during a stay of proceedings under the CCAA or BIA, it is possible that the purchaser’s right to enforce the sale agreement will be stayed unless leave of the court is obtained to enforce its rights under the sale agreement.

**6.6 Effect of Limited Recourse Provisions. If a debtor’s contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

Even if a debtor has an enforceable limited recourse provision in its contracts, it is still possible for a debtor to be declared insolvent if it cannot meet its obligations as they generally become due (for example, to taxing authorities). However, if there are only contractual creditors under limited recourse contracts then the debtor should not be declared insolvent on this ground.

## 7 Special Rules

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Canada establishing a legal framework for securitisation transactions? If so, what are the basics?**

There is no such law in Canada. There is, however, special covered bond legislation.

**7.2 Securitisation Entities. Does Canada have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

Canada has no law specifically providing for securitisation special purpose entities. In Canada, the special purpose entity used to issue notes is typically a common law trust.

**7.3 Limited-Recourse Clause. Will a court in Canada give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

A properly drafted unambiguous non-recourse clause will be enforceable, even if it is governed by a foreign law. See question 2.3.

**7.4 Non-Petition Clause. Will a court in Canada give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

Such a clause is not likely to be enforceable as it is likely contrary to public policy.

**7.5 Priority of Payments “Waterfall”. Will a court in Canada give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

Generally, a court would give effect to such a contractual provision; however, where such a provision reduces a party’s rights under that provision as a result of that party’s insolvency, such reduction in rights may not be enforceable.

**7.6 Independent Director. Will a court in Canada give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

An action taken by a corporation without the approval of an independent director in contravention of a contractual restriction not to do so would nevertheless be a valid corporate act so long as it was done within the constraints of the corporation’s constating documents. The remedy of the contract counterparty would be an action for breach of contract.

A requirement in a corporation’s constating documents, including in a unanimous shareholders’ agreement, to the effect that the corporation could not institute certain actions without an independent director’s approval should be effective to preclude such action from being validly taken without such approval.



## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Canada, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Canada? Does the answer to the preceding question change if the purchaser does business with other sellers in Canada?**

Assuming that the purchaser is not a foreign bank, merely owing receivables does not, in and of itself, require registration. Servicing receivables through an agent similarly does not require registration. However, if the activities amount to carrying on a business, registration under extra-provincial registration statutes would be required in order to maintain an action on any of the receivables. The greater the number of sellers that a purchaser deals with from a particular province, the higher the probability that the purchaser's activities would constitute carrying on a business.

In order to avoid becoming subject to regulation in Canada, it would be advisable for the purchaser to limit its connections to Canada by ensuring, as much as possible, that the following occur:

- (i) the decision to purchase the receivables is made outside Canada;
- (ii) all negotiations relating to the purchase of the receivables are either conducted outside Canada or conducted by telephone communications during which all of the officers and employers of the purchaser participating in the communications are outside Canada;
- (iii) the funding for the purchase of receivables occurs outside Canada; and
- (iv) the purchaser executes and delivers its documentation relating to the purchase outside Canada.

Provided that the purchaser is not carrying on business in Canada, no licensing would be required nor would the purchaser become subject to regulation as a financial institution.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

The need for the seller to be licensed would depend upon the nature of the sale and the nature of the receivables.

Collection by a seller of receivables on behalf of a purchaser would not require additional licensing so long as the obligors are not notified of the assignment. If obligors are notified of the assignment and the seller continues to collect receivables on behalf of the purchaser, certain provinces have collection agency statutes that could apply to require the seller to become licensed as a collection agent. A third party replacement servicer could require a licence under applicable collection agency statutes unless it was exempt from the application of such statutes (as are most financial institutions).

The collection of certain types of receivables, such as mortgages, may require special licensing under mortgage broker legislation of certain provinces.

**8.3 Data Protection. Does Canada have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

Yes. The *Personal Information Protection and Electronic Documents Act* (PIPEDA) is federal legislation that governs the collection, use and disclosure of personal information of individuals. Certain provinces have also implemented privacy legislation. PIPEDA and provincial privacy legislation apply only to individuals, not to commercial enterprises.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Canada? Briefly, what is required?**

Most consumer protection laws would apply at, or near, the time that the receivable is originated. These include cost of borrowing disclosure laws, false advertising laws and certain laws regulating motor vehicle dealers. To the extent these laws were not observed by the seller, this could provide the obligors with defences against the purchasers. To the extent that there are consumer protection laws that apply following origination, such as privacy laws, the purchaser, including a bank, would be required to comply. In Québec, the assignee of a consumer receivable will be jointly and severally liable with the assignor for the assignor's obligations toward the consumer (subject to certain statutory monetary limitations).

**8.5 Currency Restrictions. Does Canada have laws restricting the exchange of Canada's currency for other currencies or the making of payments in Canada's currency to persons outside the country?**

No, it does not.

## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Canada? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

Canada has now fully eliminated withholding tax on interest paid to arm's-length lenders, other than participating debt interest. Therefore, Canadian receivables, other than those that produce lease or royalty payments and dividends, sold to a non-Canadian purchaser that deals at arm's length with the obligor, will generally not be subject to Canadian withholding tax regardless of the jurisdiction of the non-Canadian purchaser. However, due to concerns about a non-Canadian purchaser becoming subject to Canadian tax by virtue of carrying on business in Canada through the servicing of the Canadian receivables, it is more common for an

intermediate Canadian special purpose entity to be established to purchase the Canadian receivables and for that special purpose entity to then issue an interest-bearing note to a non-Canadian investor. Discount is generally considered as interest to the holder.

Deferred purchase price (up to the original principal of the obligation) will not generally be considered to be interest.

Withholding tax of 25 per cent is generally exigible on most cross-border lease, royalty and dividend payments, subject to reduction through bilateral tax treaties.

---

**9.2 Seller Tax Accounting. Does Canada require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

---

Canadian taxpayers must generally calculate their income for Canadian tax purposes in accordance with Canadian generally accepted accounting principles (although there are a number of specific policies that permit tax treatment to be different than accounting treatment). All Canadian public companies now adopt International Financial Reporting Standards for fiscal years commencing on, or after, 1 January 2011. Specified rules exist in the Income Tax Act (Canada) for financial institutions (as defined) holding and disposing of “specified debt obligations” (as defined).

---

**9.3 Stamp Duty, etc. Does Canada impose stamp duty or other documentary taxes on sales of receivables?**

---

No, it does not.

---

**9.4 Value Added Taxes. Does Canada impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

---

The federal government imposes a goods and services tax (GST) and some provinces impose a provincial sales tax (PST) that is combined with GST into a blended harmonised sales tax (HST); certain provinces, including Québec, maintain their own PST (although Québec has harmonised its PST with the GST after 1 January 2013). These taxes apply to the transfer of certain tangible assets, such as leased automobiles and equipment. Servicing fees are also subject to GST or HST. Generally, no GST or HST is applicable to receivables that are sold on a fully serviced basis, whereby the servicing component is an ancillary part of the receivables purchase price and no separate servicing fee is charged.

Therefore, it is most common in Canada not to specify a separate servicing fee but instead to sell receivables on a fully serviced basis. However, if a replacement servicer is appointed, the replacement servicing fees would be subject to GST or HST. The GST rate is 5 per cent. The HST rate depends on the applicable province. In Ontario it is 13 per cent and in Québec there is an effective GST and PST rate of 14.975 per cent.

---

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

---

If a seller has failed to remit GST, HST or PST, failed to remit certain employee source deductions and employee and employer portions of Unemployment Insurance and Canada Pension Plan payments or failed to remit withholding taxes on payments to non-residents, the applicable tax authority may recover such taxes from the assets (or any realisation thereon) from a person who merely has a security interest in the assets on a super-priority basis. Where a true sale has occurred, assets are purchased from a seller selling in the ordinary course of business; tax liability of the seller does not attach to the purchased assets.

---

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Canada, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Canada?**

---

The answer would depend upon the specific facts of each particular situation. It is possible that the appointment of the seller as servicer and collection agent or the enforcement of the receivables against the obligors could cause a non-Canadian purchaser to be considered to carry on business in Canada and to be liable to tax in Canada on that basis. As discussed above, due to the concern with a non-Canadian purchaser being considered to carry on business in Canada through the servicing of Canadian receivables, it is more common for an intermediate Canadian special purpose entity to be established to purchase the Canadian receivables and for that special purpose entity to then issue an interest bearing note to a non-Canadian investor.

**Michael K. Feldman**

Torys LLP  
79 Wellington Street West, Suite 3000  
Toronto, ON M5K 1N2  
Canada

Tel: +1 416 865 7513  
Fax: +1 416 865 7380  
Email: [mfeldman@torys.com](mailto:mfeldman@torys.com)  
URL: [www.torys.com](http://www.torys.com)

Michael Feldman's practice focuses on corporate and commercial law, with an emphasis on structured asset-backed financing, securitisation, infrastructure finance, capital markets, secured lending, aircraft financing and derivatives.

Michael has worked on securitisation transactions involving several asset classes including auto loans and leases, dealer floorplan loans, residential and commercial mortgage, reverse mortgages, trade receivables and credit cards.

Michael's high-profile representations have led to his international recognition for his expertise. He is listed as a leading securitisation lawyer in various international publications, including Chambers & Partners' *Chambers Global*, Lexpert/American Lawyer Media's *Guide to the Leading 500 Lawyers in Canada*, Woodward White's *Best Lawyers* and Legal Media Group/Euromoney's *IFLR1000 Guide to the World's Leading Financial Law Firms*.

**Jim Hong**

Torys LLP  
79 Wellington Street West, Suite 3000  
Toronto, ON M5K 1N2  
Canada

Tel: +1 416 865 7369  
Fax: +1 416 865 7380  
Email: [jhong@torys.com](mailto:jhong@torys.com)  
URL: [www.torys.com](http://www.torys.com)

Jim Hong practises corporate, commercial and securities law, with a focus on structured asset-backed financings, securitisation, derivatives and public and private managed products. Prior to joining Torys, Jim practised in London, U.K. in the international securitisation group of a leading firm, where he advised on debt refinancing, RMBS and CDO transactions. Since then, Jim has worked on securitisation transactions involving a number of asset classes including, credit card receivables, auto loans and leases, dealer floorplan loans, residential and commercial mortgages and home equity lines of credit. Jim has been recognised as a leading securitisation lawyer in a number of publications including Chambers & Partners' *Chambers Global* and Woodward White's *Best Lawyers in Canada*.

# TORYS

LLP

Torys LLP is a highly respected international business law firm with a reputation for quality, innovation and teamwork. Our enviable record of experience combined with insight and creative problem solving have made us our clients' choice for their largest and most complex transactions and major disputes.

Torys' Securitisation and Structured Finance Practice is a focused part of our capital markets and asset-based financing practices.

A recognised leader and a frequently recommended firm in this area, our commercial, securities and tax lawyers have worked with clients to develop a number of new securitisation structures and products and have experience working with a wide variety of asset classes, including retail auto loans, vehicle and equipment leases, wholesale dealer floor plan loans, credit card receivables, variable lines of credit, trade receivables, finance contracts, CDOs, conventional and non-conventional residential mortgages and commercial mortgages.

Our practitioners represent issuers and underwriters on public offerings and private placements of asset-backed term notes, in the establishment of conduit funding programmes and in the establishment of multi-seller and single-seller commercial paper securitisation and CDO conduits.

With offices in Toronto, New York, Calgary and Montreal, Torys is capable of providing structuring, securities and tax advice on cross-border offerings of asset-backed securities, and on the cross-border sale of receivables from Canadian vendors to U.S. conduits or U.S. vendors to Canadian conduits.

# Chile

Octavio Bofill Genzsch



## Bofill Mir & Álvarez Jana Abogados

Daniela Buscaglia Llanos



### 1 Receivables Contracts

**1.1 Formalities.** In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

(a) The general rule in Chile is that contracts are perfected merely by consent of the parties. Exceptionally, Chilean law requires certain formalities to be fulfilled for publicity, perfection and/or enforceability of certain contracts, the most common of which are to be granted in writing, recorded onto private or public deeds, registrations in public records, and/or the payment of certain taxes. Nevertheless, we recommend recording most contracts onto deeds, as the lack of written evidence of the same can bring forth certain evidentiary problems (limitations on witness depositions). In addition, Law No. 18,045 on the Securities Market provides that securitisation companies, in fulfilling their corporate purpose, may acquire, in general, transferable credits and rights that are evidenced in writing.

(b) Pursuant to Law No. 19,983 on the Enforceability of Invoices, invoices shall be enforceable by themselves, insofar as they meet the requirements established by said law.

(c) The Chilean Civil Procedure Code expressly lists out the forms of evidence that may be used in any civil litigation: (i) instruments or documents; (ii) witness depositions; (iii) *ex parte* confessions; (iv) personal inspection of the court; and (v) presumptions. Notwithstanding the limitations on witness depositions mentioned in letter (a) above, the parties’ behaviour may be admitted as a basis for a judicial presumption in connection with the existence of a receivable contract. A receivable contract can exist as a result of the mere consent of the parties, provided it is granted in writing (plus certain additional formalities) and it includes a non-challengeable obligation to pay, to provide or to not provide (along with other requirements such as in case of payment obligations, the amount shall be determined therein or the arithmetic therein allows to specifically conclude the amount to be paid).

**1.2 Consumer Protections.** Do Chilean laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

(a) In the context of cash credit transactions (among which we include discounts transactions of cash representative documents, since they are considered as cash), gratuity is not presumed, and therefore, unless otherwise established by law or contract, said transactions shall accrue ordinary interest, calculated over the principal. Law No. 18,010 on Cash Credit Operations establishes the maximum interest limit that can be agreed, that is, the “maximum conventional interest”, corresponding to 50 per cent of the ordinary interest in force at the time of the respective transaction. In turn, ordinary interest is the average interest rate charged by Chilean banks and financial institutions for transactions conducted in Chile, and it is determined by the Central Bank. Transactions carried out by the Central Bank with financial institutions are exempted from this limitation. The sanction for establishing an interest rate above the legal threshold is that it will be reduced to ordinary interest. The Civil Code is consistent with these principles in establishing a threshold for interest rates in the *mutuum* or consumption loan contract, namely an additional half of the ordinary interest rate in force at the time of perfection of the contract. In the case of simple cash obligations, they shall only accrue interest when the parties have so agreed or if the law expressly so provides (an example of the latter is found in bills of exchange, which accrue interest as of their maturity pursuant to Law No. 18,092 on Bills of Exchange and Promissory Notes).

(b) There is no legal requirement in connection with late payment interest, unless expressly agreed by the parties in general and the natural accrual of interest up to the actual payment in cash credit transactions, as mentioned in letter (a) above.

(c) As mentioned in question 1.1(a) above, the general rule is that contracts are consensual, and thus there is no right or term during which the parties may retract their manifestation of intent for the purposes of rendering said contract without effect. As an exception, Law No. 19,496 on Consumer Protection establishes that in contracts delivered by electronic means, or those in which a party accepts an offer made in any remote form of communication, the consumer shall enjoy a term of 10 days during which it may unilaterally terminate the contract with no right to compensation for

the other party, and, consistently, the latter shall return all sums paid or disbursed, with the exception of services that were actually rendered by the date of the retraction.

### 1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

In connection with the disposal of bonds and other public debt securities issued by the State, article 47 *bis* of Law Decree 1263 of the Ministry of Treasury establishes that said Ministry, in the supreme decree attached to the corresponding issuance of securities, shall indicate the applicable procedure to their transference, which may be specific or subject to the general rules. In this same vein, the Chilean Code of Commerce provides that the assignment of tradable public securities must be conducted in the manner determined by the laws that created said securities or the decree authorising their enforcement. As regards the judicial collection of securities against the state or its organs, we must determine whether the organ has legal personality (if this is the case, then the general procedural rules shall apply; if not, the collection proceedings will be instructed against the state subject to the rules on “State Treasury Litigation”).

## 2 Choice of Law - Receivables Contracts

### 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Chile that will determine the governing law of the contract?

Chile is governed by the principle of territoriality of the law, and thus domestic law governs all legal situations arising within the territory of Chile, whether between Chileans or foreigners. Parties’ consent prevails in the choice of law.

### 2.2 Base Case. If the seller and the obligor are both resident in Chile, and the transactions giving rise to the receivables and the payment of the receivables take place in Chile, and the seller and the obligor choose the law of Chile to govern the receivables contract, is there any reason why a court in Chile would not give effect to their choice of law?

No, there is not.

### 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Chile but the obligor is not, or if the obligor is resident in Chile but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Chile give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

In light of the principle of autonomy of intent, parties may choose a foreign law to govern their contractual relationship. The above notwithstanding, a Chilean court may set aside this contractual provision if it entails an affectation of national sovereignty, public order provisions and morality standards (which we do not foresee in the simple form of the case provided in this question).

### 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Chile?

Yes, with the express reservation that if any of the parties to a contract has its establishment in Chile, the CISG rules shall not apply in respect of the perfection, amendment or mutual termination of the sale contract or any offer, acceptance or other manifestation of intent, if they are not in writing.

## 3 Choice of Law - Receivables Purchase Agreement

### 3.1 Base Case. Does Chilean law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Chilean laws or foreign laws)?

There is no legal requirement in that regard. General rules will apply. Although, if Chilean law would be the choice of law to rule the sale of receivables, one must take into account that receivables are formal documents defined under Chilean law, hence, the purported “receivable” shall meet such requirements in order to allow the sale of receivables regulation to be applicable.

### 3.2 Example 1: If (a) the seller and the obligor are located in Chile, (b) the receivable is governed by the law of Chile, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Chile to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Chile, will a court in Chile recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes, the Chilean court would recognise the sale as being effective.

### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Chile, will a court in Chile recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

The Chilean court will apply Chilean law disregarding the foreign law.

### 3.4 Example 3: If (a) the seller is located in Chile but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Chile recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Chile’s own sale requirements?

Yes, the court in Chile will recognise that sale as being effective against the seller and other third parties without the need to comply

with Chilean own sale requirements. Insolvency rules can be applicable (such as revocation of the sale when fraud damaging creditors would have occurred) since they are considered public order rules.

**3.5 Example 4: If (a) the obligor is located in Chile but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Chile recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Chile's own sale requirements?**

The answer is the same as that to question 3.4.

**3.6 Example 5: If (a) the seller is located in Chile (irrespective of the obligor's location), (b) the receivable is governed by the law of Chile, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Chile recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Chile and any third party creditor or insolvency administrator of any such obligor)?**

The answer is the same as that to question 3.4.

## 4 Asset Sales

**4.1 Sale Methods Generally.** In Chile what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

Sales of receivables are typically conducted through the so-called assignment of credits.

**4.2 Perfection Generally.** What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

In spite of the fact that the memorialisation of a contract is sufficient for its validity *vis-à-vis* the seller and purchaser, the perfection of the assignment of credits in respect of the obligor and third parties shall depend on the nature of the credits.

The assignment of nominative credits requires the material conveyance of the title in which the credit is recorded and a notice sent to the obligor in connection with the assignment or its acceptance. In certain cases the debtor is reserved with the right to reserve its arguments of defence against the latter creditor (the assignor).

The Code of Commerce and other specific statutes govern the assignment of credits issued "to the order of the creditor" (as an opposite concept of "nominative credits"), and it is perfected via the

endorsement of the title. The assignment of credits issued to the bearer does not require formalities other than the conveyance of the title between seller and purchaser.

Similarly, there are specific statutes (*inter alia*, Laws No. 18,045, No. 18,092, No. 19,281 on Housing Leases with Promises of Purchase) that establish particular mechanisms for the perfection of the assignment.

Finally, Law No. 18,045 establishes, in connection with the creation of separate patrimonies, that the assignment or transference of contracts, credits and rights, or their respective titles, will be enforceable *vis-à-vis* their corresponding obligors, as of the date of the deed containing the issuance of the securitised bond(s). As of that date, the obligors may not invoke defences but for their personal defences against the creditor.

**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

Pursuant to Law No. 18,092 the assignment of a promissory note, bill of exchange or cheque is carried out through the endorsement of the respective document in favour of the purchaser. In the context of consumption loans and mortgage loans, the obligor must be notified, with the exception of endorsable mortgage loans, in which case a written endorsement made in the margin, or on the back of a certified, endorsable copy of the respective public deed, will suffice. Finally, sales of tradable securities in the securities market shall also require the fulfilment of certain disclosure and registration obligations before the Superintendence of Securities and Insurance ("SVS").

**4.4 Obligor Notification or Consent.** Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

As mentioned in question 4.2 above, the assignment of nominative credits requires a notice to or the acceptance by the obligor, which notice is generally sent by the purchaser, since it has greater interest in holding a valid and enforceable title. However, the seller may also notify the obligor.

If the assignment of receivables is not forbidden but not expressly allowed either, the assignment must be performed pursuant to the rules indicated in question 4.2 above. If there is an explicit prohibition on the assignment, the prohibition prevails (in the sense that the obligor retains its right to validly pay to the original creditor and to base its non-payment arguments on the legal liaison with the original creditor). Nonetheless, and in respect of certain receivables (i.e., invoices), these prohibitions have no standing in our legal system.

Once the assignment has been perfected, whether it required a notice, acceptance, endorsement or the mere conveyance of the title, the assignment shall be binding upon the obligor and third

parties, and the purchaser acquires the rights of the seller against the obligor.

**4.5 Notice Mechanics.** If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

When referred to nominative credits and no expressed acceptance by the obligor is granted, the notice has to be given through the courts. That is why certain special rules have created other means in order to facilitate perfection of the assignment such as with the case of Law No. 19,983.

Generally speaking, there is no time limit associated with the notice or acceptance of a credit assignment, and in fact, notice is usually carried out after the corresponding assignment. However, and despite having perfected the assignment between seller and purchaser, as long as the obligor has not been notified, it shall be authorised to pay the credit to the seller, the credit may be subject to seizures by the seller's creditors, and the purchaser shall have no direct collection claim against the obligor.

Notice applies to the assignment of specific nominative receivables. (Save for Law No. 18,045 in connection with the creation of separate patrimonies, where the assignment can be applicable to future receivables to be listed with the separate patrimonies deed.)

**4.6 Restrictions on Assignment - General Interpretation.** Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?

Yes to both questions, except regarding certain receivables, as detailed in the answers to questions 4.4 and 4.7.

**4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Chile? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Chile recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

In case of nominative credits, if there is an explicit prohibition on the assignment, the prohibition prevails (in the sense that the obligor retains its right to validly pay the original creditor and to base its non payment arguments based on the legal liaison with the original creditor). Nonetheless, and in respect of certain receivables these prohibitions have no standing in our legal system (i.e., in

accordance to Law No. 19,983, it is forbidden that any agreement, provision or action of any nature limits, restricts or prohibits the free transaction of the credits included on invoices).

**4.8 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells *all* of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

In order for an agreement to be valid it is necessary for its object to be determined or susceptible of determination. Although there is no general provision that requires the complete identification of each of the sold receivables or the type of information that is required in this regard, minimum information to allow the due identification of the assigned receivables is necessary. Particularly, Law No. 18,045 requires that the issuance agreement or the placement deeds, as applicable, include the identification or specification of the assets, agreements, credits and rights that shall comprise the separate patrimony, in attention to their nature. Furthermore, if the aforementioned deeds do not allow for their identification or specification, it shall be necessary to detail their main characteristics, degree of homogeneity, their number, the term in which they shall be acquired and any other references that the SVS requires, postponing their identification for future complementary deeds. In domestic securitisations a discussion has been held as to the degree of specification that needs to be included in the assignment deed. In certain cases deals have included only serial numbers which are backing further information that remains undisclosed to the public. Such criteria has not been challenged at the courts.

There is no general provision that requires assigned receivables to share objective characteristics among each other; however, Law No. 18,045 imposes a degree of homogeneity between the assets that shall form part of the separate patrimony and even in the event of substitution of assets, demanding that such substitute assets comply with similar characteristics as the assets that are replaced.

A declaration in connection to the assignment of *all* receivables, regardless of their nature (whether same are nominative, to the order or to the bearer), without at least specifying the elements that allow for their determination, would not be considered sufficient and its validity may be challenged with sufficient grounds in our opinion.

**4.9 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale, will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

The mere fact that the parties denominate their transaction as a sale and state their intent that it be a sale will not automatically be respected; a court could enquire into the economic characteristics of

the transaction. Such could be contested before a court if the economic characteristics of the operation evidence the execution of a simulated agreement. Basically the economic characteristic of a sale that determines the presence of a sale is the price. In addition, such sale has to conduct to the right to transfer ownership over the receivables sold. Further, in order to challenge a purported sale not being such but in presence of a different agreement (for example, collateral or security agreement) the presence or absence of the elements of both type of agreements have to be considered. Although contractually the parties may alter the general rules and agree on special provisions (i.e.: generally the seller is liable for the existence of the credit at the time of the assignment, as well as with regards to the present and future solvency of the debtor only if it agrees on one or the other; the establishment of re-purchase rights under specific cases), the economic characteristics of the operations may reveal a declared intention that is far from the real intention of the parties. We are of the opinion that the seller may retain full credit risk; control of collections of receivables; and a right (as long as it is a right in its full control) of repurchase/redemption without jeopardising perfection of the sale. If it were to retain the interest rate risk, one would assume there is no intent to transfer ownership.

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

Yes it can, through a promise agreement which can be enforceable in nature.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?**

Under common terms the sale of future goods is subject to the condition precedent of the existence of the goods. Once in existence the creditor can claim the enforcement of the sale, but does not prevail *vis-à-vis* third parties.

In domestic securitisation the sale of future flows is accepted as an asset class, and we have given the opinion that such creates a preference, although such criteria has not been challenged in the courts.

Regarding bankruptcy, see section 6.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

The assignment of credits also entails the assignment of the related securities that were executed to secure their compliance. The methods customarily adopted depend upon the nature of the related security. Personal guarantees attached are typically confirmed by the guarantor.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

Set-off rights depend on the existence of enforceable obligations between the parties, thus it is a legal requirement that both parties shall have pending debts or amounts *vis-à-vis* the other, therefore general set-off rights do not depend on the sale of one or more receivables, and in the event of a sale where the new holder of the receivable is the purchaser, specific obligor’s set-off rights against the seller do not apply to the sold receivable, but specific obligor’s set-off rights against the purchaser. The seller or the purchaser shall only be liable in general terms.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Chile to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

In Chile it is not customary to take on a “back-up” security interest, even when it could be perfectly agreed by the seller and purchaser. Nevertheless, every seller has the obligation of protecting (compensating) the purchaser with regard to the ownership and peaceful possession of the sold asset when a court ruling orders its complete or partial confiscation (warranty of title). It is relevant to mention that the seller may contractually waive this obligation.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Chile, and for such security interest to be perfected?**

In the warranty of title mentioned in question 5.1: (i) the cause of the deprivation of property must be dated prior to the sale, although the parties may agree that such cause be prior or subsequent to the sale; and (ii) the purchaser must summon the seller for the latter to defend the former.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Chile to grant and perfect a security interest in purchased receivables governed by the laws of Chile and the related security?**

Such security can be provided through a pledge with non conveyance. A public deed or equivalent must be granted and registration with the pledge registration must be executed in order to perfect the security right.



**5.4 Recognition.** If the purchaser grants a security interest in receivables governed by the laws of Chile, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Chile or must additional steps be taken in Chile?

No. The validity and perfection of the acts and agreements granted and executed abroad is generally acknowledged in Chile, although, for them to be executed in our country they must comply with the requirements that would have been observed had they been perfected in Chile. The additional steps to be taken in Chile would be to perfect such security (such as those referred to in the previous answer).

**5.5 Additional Formalities.** What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

In addition to question 4.3 above, there are drafting, notice and registration requirements that must be complied with before public registries, within specific terms, depending on the nature or type of guarantee.

**5.6 Trusts.** Does Chile recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?

Other than for securitisation purposes (as explained in question 7.1 below) or in case of private or public funds, there is no general statute for trusts in Chile whereby assets are considered to be apart from the remaining patrimony of the owner.

**5.7 Bank Accounts.** Does Chile recognise escrow accounts? Can security be taken over a bank account located in Chile? If so, what is the typical method? Would courts in Chile recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Chile?

No, Chilean legislation does not recognise escrow accounts. Although contractually they are used, allowing therefore for the execution of a security, typically a pledge, over the banking accounts and the funds that are deposited in the same. The way it is structured is to open the account in the name of creditors or agents who are mandated to conduct the flows in a certain manner. In turn, the security granted above such funds is a pledge.

See question 5.4 regarding the acknowledgment in Chile of a security granted under foreign law.

**5.8 Enforcement over Bank Accounts.** If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Such enforcement is possible and the sole limitation would be the general rights of creditors based on insolvency laws (preferred creditors would prevail).

**5.9 Use of Cash Bank Accounts.** If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

The pledge does not prevent, in itself, the free use and disposal of the funds in the account, however, it is customary to set forth a ban applicable to the encumbrance, disposition, uses and limited investments as well as minimum balance amounts that shall be observed in specific dates, in order to prevent the deterioration of the security.

## 6 Insolvency Laws

**6.1 Stay of Action.** If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Chilean insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

In case a sale is perfect and the seller's bankruptcy is declared, the seller is not automatically prevented from exercising its ownership over the validly acquired receivables.

The only way in which the receivables could return to the seller's patrimony and, subsequently, to the administration of the insolvency official, is through revocation actions exercised by the insolvency official or any creditor in connection to the assignment of the receivables, in the event that such assignment was performed damaging or defrauding the seller's creditors.

In case the purchaser is a secured creditor and not the holder of the receivables, and in the event of the seller's bankruptcy, said receivables shall be managed by the insolvency official.

**6.2 Insolvency Official's Powers.** If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?

See question 6.1.

**6.3 Suspect Period (Clawback).** Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Chile for (a) transactions between unrelated parties, and (b) transactions between related parties?

Regarding the common debtor, the following shall be subject to annulment: (i) gratuitous acts or agreements executed between 10 days prior to suspension of payments and up to the date of the bankruptcy declaration (term that may be extended up to 120 days if the act was executed with a relative); and (ii) lucrative acts or agreements executed at any time in which both parties are in bad faith, that is, having known the poor financial state of the bankrupt party (fraud). For these purposes, the law establishes that bad faith

shall be presumed regarding the acts that are performed within the term elapsing between 10 days prior to the date of suspension of payments and the date of the bankruptcy declaration.

Regarding the qualified debtor (one that performs a commercial, industrial, agricultural or mining activity), the following acts shall not be enforceable against its creditors: (i) early payments, payment in kind or the execution of real guarantees to secure prior obligations, performed during the term elapsed between 10 days prior to the date of suspension of payments and up to the date of the bankruptcy declaration; (ii) lucrative acts executed between the date of suspension of payments up to the date of declaration of bankruptcy, when both parties have performed the same in bad faith; (iii) compensations performed as of the date of suspension of payments and up to the date of declaration of bankruptcy, regarding the receivables that have been acquired against the bankrupt party via assignment or endorsement; and (iv) mortgages which were registered subsequent to the date of suspension of payments and prior to the declaration of bankruptcy, with more than 15 days elapsing between the day of execution of the security and its registration, with the insolvency official having declared its unenforceability.

The actions to dispute the acts shall be subject to the statute of limitation within a term of two years, as of the date of execution of the corresponding act or agreement, and shall be suspended for up to two years as of the date of declaration of bankruptcy.

There is no specific rule regarding operations between related parties.

Please note that as of 9 October 2014, a new insolvency law, Law No. 20,720, will be in force in Chile, and pursuant to it the suspect period and effects of transactions performed therein are subject to said new legal framework, described hereafter.

Regarding the qualified debtor, now referred to as “debtor company” (all legal entities and individuals that are subject to first category tax or that are independent professionals), and also the common debtor (individuals and legal entities that do not qualify as debtor company), now referred to as “debtor person”, the following acts are subject to revocation if performed in the year previous to the commencement of the insolvency procedure: (i) early payments; (ii) payments of matured debts in a manner different than the previously set forth by the parties (considering payment in kind of securities as cash); and (iii) all mortgages, liens and encumbrances given over the debtor’s assets to secure previous obligations. If said transactions were entered into with related parties (which are defined in the new insolvency law as: (1) relatives up until the sixth degree and the entities in which they participate, unless said entities are registered in the SVS; (2) entities of the debtor’s corporate group; (3) the debtor’s controllers, affiliates and subsidiaries; (4) the debtor’s directors, key executives, managers or liquidators and the entities they control; and (5) every person, or persons if they act jointly, that can designate a board member or controls at least 10 per cent of the debtor, or if any transaction was performed gratuitously, the term of one year shall be extended to two years.

Also, for the debtor person, every other lucrative act or agreement entered into by the debtor previous to the commencement of the insolvency procedure is subject to be revoked.

Regarding the debtor company, every act or agreement entered into by the debtor is subject to be revoked if performed in the two years previous to the commencement of the insolvency procedure, if the following conditions are met: (i) the other party is aware of the poor state of the debtor’s business; and (ii) said act or agreement causes patrimonial damage to the creditors or alters the equal position all of them had *vis-à-vis* the debtor. Also, regarding the debtor company, every amendment to the debtor’s bylaws is subject to be

revoked if performed in the six months previous to the commencement of the insolvency procedure, if said amendment diminishes the debtor’s patrimony. Also, if said amendment reduces the patrimony of the debtor’s affiliates or subsidiaries, and if they are personally securing debtor’s obligations, they shall not be enforceable against third parties that have entered into previous agreements with said affiliates or subsidiaries.

The actions to dispute the acts shall be subject to the statute of limitation within a term of one year, as of the date of the commencement of the insolvency procedure.

---

#### **6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

---

Such possibility is not considered by Chilean legislation. Revocation is the sole available remedy.

---

#### **6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Chile, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

---

In bankruptcy proceedings the bankrupt defendant loses the management of its assets, entrusting the same to the insolvency official. Insolvency proceedings do not automatically trigger early termination of binding agreements; hence, if a sale of receivables was enforceable against the debtor prior to insolvency, it remains the same after becoming insolvent. As to the future receivables, please refer to previous responses.

---

#### **6.6 Effect of Limited Recourse Provisions. If a debtor’s contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

---

For a debtor to be declared bankrupted under Chilean law, objective criteria shall be met, therefore, if the failure to comply with its debts, even under a Limited Recourse Provision, is enclosed in one of the hypotheses set forth by law, either the currently in force law or the soon to be in force new insolvency law, a debtor could be declared as insolvent.

## **7 Special Rules**

---

#### **7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Chile establishing a legal framework for securitisation transactions? If so, what are the basics?**

---

Title XVIII “On Securitisation Companies and the Issuance of Securitisation Debt Titles” of Law No. 18,045, establishes a regulatory framework for securitisation in Chile. It consists of a finance mechanism through which the creditor of a group of receivables, for financing reasons, assigns such receivables at a specific price to a securitisation company, which acquires them for itself in order to form a separate patrimony, different from its

common patrimony. To finance the purchase, the securitisation company issues a securitised bond in the stock exchange, in consideration to the assets of the separated patrimony that has been formed.

Also private funds law are vehicles used to structure domestic securitisation programmes.

**7.2 Securitisation Entities. Does Chile have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

(a) They must be incorporated as special share corporations with a capital that may not be inferior to 10,000 *Unidades de Fomento* (approximately USD 490,000), and its exclusive corporate purpose must be the acquisition of financial assets, rights over payment flows, the issuance of debt short or long term debt titles, and any other activity that is authorised by the SVS. They are subject to the existence authorisation and operational supervision of the SVS.

(b) The bankruptcy of securitisation companies only affects their common patrimony and shall not trigger the bankruptcy of the separated patrimonies that they have incorporated, only causing the liquidation of the latter.

(c) Their directors and shareholders are subject to the information duties with regards to the SVS, and in all matters that are not addressed by Law No. 18,045, securitisation companies are ruled by the general provisions applicable to share corporations.

**7.3 Limited-Recourse Clause. Will a court in Chile give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

Yes, it will.

**7.4 Non-Petition Clause. Will a court in Chile give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

For (a) no, since it is a public order issue. For (b), it would be debatable since the commencing of insolvency proceeding is not exclusive to one creditor, hence, one could argue that such prohibition restricts the mere right of the prohibited creditor.

**7.5 Priority of Payments "Waterfall". Will a court in Chile give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

Yes, contractual subordination is accepted in Chilean law (Civil Code), although such law does not specify the applicability of the contractual subordination in case of insolvency proceedings.

**7.6 Independent Director. Will a court in Chile give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

No, attributions of directors are public order rules.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Chile, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Chile? Does the answer to the preceding question change if the purchaser does business with other sellers in Chile?**

Generally, no. Certain securities intermediation activities require incorporation and operation pursuant to law, as well as registration before, and prior authorisation from, the SVS or the Superintendence of Banks and Financial Institutions. In any event Chilean tax laws will be applicable since the source of income remains in Chile.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

Such will follow the same principles explained in question 8.1: if the entity has to be licensed, such licence entitles to follow with the collection procedures; if not, such party will follow collection procedures with no additional requirement, which also counts for the replacement servicer.

**8.3 Data Protection. Does Chile have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

Yes, Law No. 19,628 on the Protection of Private Life, only applicable to personal data of individuals and not of any kind of legal entity, sets out that the treatment of private data can only take place when said treatment is authorised by law or the holder of the respective data.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Chile? Briefly, what is required?**

In the event that the obligors fall within the meaning of consumers pursuant to Law No. 19,496, there may be ascribed certain rights and obligations to both parties. As regards the supplier's obligations, it is possible to highlight those regarding its duty to make available to the consumer truthful, correct, clear and appropriate information in respect of the respective good or service, even before the execution of the relevant legal act and up to the

termination of the obligation assumed. As regards obligations assumed in connection with borrowings, the supplier shall send to the consumer on a quarterly basis all information pertaining to said obligation, and it shall also be bound to deliver that information every time the consumer so requires.

**8.5 Currency Restrictions. Does Chile have laws restricting the exchange of Chilean currency for other currencies or the making of payments in Chilean currency to persons outside the country?**

No restriction applies for such purposes.

## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Chile? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

Payments abroad may be subject to withholding taxes in Chile, depending on the nature of the payments and the purchaser's and seller's place of residence. The withholding rate ranges between 0 per cent and 35 per cent, depending on the payment cause and the existence of an agreement to avoid double taxation with the country of residence. In light of the complexity of the Chilean legislation's withholding tax, each transaction must be thoroughly analysed from a tax perspective.

Regarding the sale of the trade receivables (invoice) at a discount rate, a greater value is immediately generated for the purchaser and since invoices are issued in Chile, the Chilean tax authority could consider difference as Chilean source income, subject to withholding taxes in Chile. If the trade receivable is a document representative of a monetary obligation (with or without liability for the assignor), any discount would be deemed as an interest in accordance with Section 2 of Law Number 18,010 and withholding tax would apply over the interest.

Regarding the sale of trade receivables, where a portion of the purchase price is payable upon the collection of the receivable, no specific legal disposition nor administrative ruling considers such as greater interest. However, this condition shall affect the market price of the transaction, which reasonably could be higher (our tax authority has the power to assess the prices when they are not at market level). This is, under the understanding that no services of assignment collection or recovery will be provided. If this is not the case, such service received from abroad and its associated fee will be subject to a 35 per cent withholding tax rate. However, for more precise information an IRS ruling could be obtained.

**9.2 Seller Tax Accounting. Does Chile require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

From an accounting point of view, the securitisation transactions' recording is based upon the IFRS accounting principles. Pursuant

to tax law, the general provisions set out in the Income Tax Law govern purchases of credits in the context of a securitisation process. However, if the credit is acquired by a Chilean company which engages in securitisation transactions, the difference between the securitised credit's acquisition value and par value is not deemed as income, but only the result obtained when comparing the duly corrected credit's acquisition cost with the cost of its partial or complete recovery charged when said credit is collected, or its sale price if the same is sold.

Furthermore, when within the context of a securitisation process a Chilean taxpayer levied with the corporate tax assigns or promises to assign all or a part of the "payment flows" generated after the assignment date, covering more than one fiscal year in connection with sales or services, the special provisions of Chilean Income Tax law shall apply.

**9.3 Stamp Duty, etc. Does Chile impose stamp duty or other documentary taxes on sales of receivables?**

The Chilean stamp tax levies all documents containing a credit transaction. In case the seller's purchase or assignment of accounts receivable falls within the meaning of "discount transaction", the stamp tax shall levy upon the respective contract. In case of other credits, an assessment of the foregoing must be carried out (the assignment of invoices does not constitute a credit transaction). As regards credit transactions coming from abroad, the documentary nature of the taxable event is not required.

**9.4 Value Added Taxes. Does Chile impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

The value added tax ("VAT") does not levy the sale of intangible assets; therefore, the assignment of credits is exempted from this duty. Nor are collection fees levied with VAT, unless the service is rendered by a bank (in Chile, banking services are levied with VAT). Fees charged for administration and custody of assets comprising a separate group of assets paid by Chilean companies engaged in securitisation transactions, are exempted from VAT.

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

With respect to VAT, the "service provider" is the person liable for VAT, having the obligation to levy VAT upon the respective transaction amount and pay the levied duty to the state taxing authority within the first 12 days of the month following that on which the transaction took place.

As regards the stamp tax, the law provides for different scenarios depending on the person liable for said tax in each case, but said condition is not transferred with the assignment of the credit. If a person intervenes in the taxable event in the capacity of agent or representative of someone, said agent or representative shall be joint and severally responsible for the payment of this tax.

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Chile, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Chile?**

No, provided that the purchaser does not have domicile or reside in Chile, and does not constitute a permanent establishment therein.

Treaties to avoid double taxation subscribed by Chile broaden the concept to even encompass cases in which foreign personnel are transferred to Chile to render professional or similar services for a specific period of time, or to act through a dependent agent, who does not act within the ordinary scope of his activity, and with whom conditions other than those agreed by an independent agent are agreed upon or imposed.



**Octavio Bofill Genzsch**

Bofill Mir & Álvarez Jana Abogados  
2711 Andrés Bello Av., 8th Floor  
Costanera Tower  
Las Condes, Santiago  
Chile

Tel: +56 227 577 600  
Fax: +56 227 577 601  
Email: [obofill@bmaj.cl](mailto:obofill@bmaj.cl)  
URL: [www.bmaj.cl](http://www.bmaj.cl)

Mr. Bofill is a senior partner of BMAJ, admitted to practise in Chile since 1990, a member of the Chilean Bar Association and the Chilean Institute of Trade Law, Professor of Corporate Law at the Universidad de Chile since 1992, and an arbitrator of the Chilean Chamber of Commerce. He received his J.D. degree, *cum laude*, from the Universidad Católica de Valparaíso, and previously worked at Jorge Bofill Vergara (1983-1987), the Chilean Army (1985-1987) and the firms Magasich & Cia. (1987-1990), Slaughter & May, London (1994), Allgemeines Treuunternehmen, Liechtenstein (1994), and Grasty Quintana Majlis & Cia., Chile (1990-2006). His practice focuses on Commercial and Corporate Law, Mergers and Acquisitions, Banking, Finance and Securities, Regulated Markets and Competition Law; he has vast experience dealing with and providing advice to financial institutions and private clients, leading significant transactions in Chile and abroad on a wide range of matters, including structured project finance, bond issuances and other operations in the Chilean capital market, being a pioneer on domestic securitisation and continues to be a specialist in said area. Mr. Bofill's work and experience is permanently recognised by the rankings of *Chambers Global*, *Chambers Latin America*, *Latin Lawyer* and *Best Lawyers International*. He is co-author of the Chilean chapter of "The International Comparative Legal Guide to: Securitisation 2013", published by *Global Legal Group Ltd.* (2013).



**Daniela Buscaglia Llanos**

Bofill Mir & Álvarez Jana Abogados  
2711 Andrés Bello Av., 8th Floor  
Costanera Tower  
Las Condes, Santiago  
Chile

Tel: +56 227 577 600  
Fax: +56 227 577 601  
Email: [dbuscaglia@bmaj.cl](mailto:dbuscaglia@bmaj.cl)  
URL: [www.bmaj.cl](http://www.bmaj.cl)

Ms. Buscaglia is a senior associate of BMAJ, admitted to practise in Chile since 2006, and a member of the Chilean Bar Association. She received her J.D. degree, *cum laude*, from the Universidad de Chile, is a candidate for the LL.M. degree in Law and New Technologies from the Universidad de Chile and candidate for the LL.M. degree in Intellectual Property and Information Law from King's College London, and previously worked at Grasty, Quintana, Majlis & Cia., Chile (2002-2006). Her practice focuses on Commercial and Corporate Law, Mergers and Acquisitions, Finance and Securities and Intellectual Property Law and she has extensive experience on national transactions including general corporate matters and domestic securitisation. She is co-author of the Chilean chapter of "Getting the Deal Through - Corporate Governance 2010", published by *Law Business Research Ltd.* (June, 2010) and of the Chilean chapter of "The International Comparative Legal Guide to: Securitisation 2013", published by *Global Legal Group Ltd.* (2013).



**BOFILL MIR & ALVAREZ JANA**  
Abogados

**Bofill Mir & Álvarez Jana Abogados (BMAJ)** is one of the fastest growing firms in recent years in Chile. It has over 70 lawyers, professionals with the highest academic backgrounds and specialists in all areas of law. The quality, creativity and efficiency of the firm's professionals has established BMAJ as a full service firm and trusted legal counsel in complex Chilean and international transactions and disputes. BMAJ's attorneys have a solid and diverse international legal background that distinguishes them from other Chilean law firms. BMAJ's attorneys have graduated from the most prestigious Chilean universities, and many have post-graduate degrees awarded by first class universities in the United States, Great Britain, Canada, France, Germany, Holland and Chile. Some of BMAJ's lawyers are qualified to practise law in the United States, France and Canada. The firm has a strong commitment in matters of public interest and is a permanent advisor to Chilean Governmental Secretaries and legislative commissions on several specific Chilean laws reforms. Many of BMAJ's professionals have teaching positions at Universidad de Chile, Pontificia Universidad Católica and other major Chilean universities. Likewise, BMAJ actively promotes participation of its members in *Pro Bono* activities, particularly in conjunction with Chile's *Fundación Pro Bono*. BMAJ is continuously listed on the most important world legal rankings (*IFLR 1000*, *The Legal 500*, *Chambers Global*, *Chambers Latin America*, *Latin Lawyer*, *Who's Who Legal* and *Best Lawyers International*).

# China



Roy Zhang



Ma Feng

King & Wood Mallesons

## 1 Receivables Contracts

- 1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

According to the *General Principles of the Civil Law of Peoples’ Republic of China* (“PRC”), a debt obligation could be created by a contract. Generally speaking, PRC laws do not mandatorily request the sale of goods or services to be evidenced by a formal receivables contract, instead, the *PRC Contract Law* allows a contract to be concluded in writing (including formal written contract, letter or electronic communications), oral or other forms. Such general principle is subject to certain exceptions created by other laws, for instance, the PRC’s *Property Rights Law* requests a formal written contract for the transfer of land use rights.

In the PRC, invoices shall be produced in standard format and used for tax purposes only. An invoice alone is insufficient to evidence the conclusion of an enforceable debt obligation of the obligor to the seller, unless it is coupled with other evidence; such as communications between the parties and the conduct of the parties.

A receivable “contract” may be deemed to exist as a result of the behaviour of the parties, provided that such behaviour covers the performance of major obligations by the seller and the acceptance by the obligor in respect of the seller’s such performance.

- 1.2 Consumer Protections. Do PRC laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

**(a) Limit of Rates of Interest**

PRC laws do not limit rates of interest on loans denominated in currencies other than RMB, the lawful currency of the PRC. Commercial banks are able to freely negotiate the interest rate of foreign exchange loans with their borrower.

The interest rates of RMB loans extended by commercial banks are regulated by the Peoples’ Bank of China (“PBOC”), which will, from time to time, issue benchmark interest rates of RMB loans for different tenors. Since October 2004, commercial banks are not subject to ceilings of interest rates for RMB loans, while since 20

July 2013, they are not subject to interest rate floor for RMB loans either.

According to the *General Principles of Loan* issued by the PBOC in 1996, entities other than commercial banks and other financial institutions approved by the banking regulator, are not allowed to extend a loan in the PRC. However, PRC laws do not prohibit private lending involving individuals, either acting as a lender or borrower. The interest rates of such private lending are not subject to PBOC’s regulatory requirements imposed on commercial banks, but according to an interpretation issued by the PRC’s Supreme Court on 2 July 1991, it shall not exceed four times the rate applied by commercial banks generally for the same type of loan.

**(b) Interest on Late Payment**

According to the *PBOC’s Rules on Interest Rate of RMB Loan*, the late repayment of a RMB loan borrowed from commercial banks shall be subject to the default rate, which could vary from 130 per cent to 150 per cent of the interest rate as stipulated in the relevant RMB loan agreement.

Other than the default rate applicable to RMB loans granted by commercial banks, there is no statutory right to interest on late payment in the PRC. However, as general principles created by the *PRC Contract Law*: (i) the parties are allowed to agree on interest on late payment in contract, provided that such interest on late payment is not excessively higher than the actual loss suffered by the non-defaulting party, otherwise the defaulting party may apply to the People’s Court or Arbitration Tribunal for adjustment; and (ii) where there is no agreement regarding interest of late payment, the non-defaulting party is allowed to claim for compensation caused by such late payment through the People’s Court or Arbitration Tribunal.

**(c) Consumer’s Rights to Cancel Receivables for a Specified Period of Time**

The *PRC Consumer Protection Law* does not vest the consumers with a right to cancel receivables for a specified period of time. The State Administration of Industry and Commerce released the *Administrative Measures for Online Trading* on 26 January 2014, which came into effect from 15 March 2014. According to such rule, subject to exceptions as provided therein, where an online commodity operator sells commodities, the consumer is entitled to return the commodities within seven days from the date following receipt of the commodities without giving a reason.

In addition, there are some provincial level consumer protection rules and regulations applicable to specific marketing methods that impose “cooling-off” periods for the benefit of consumers that would enable consumers to withdraw from their commitment to transactions that they have previously entered into, for example:

- (i) Pursuant to the *Regulations on Direct Marketing* issued by the State Council in 2005, where the consumer purchases goods under a “direct marketing”, namely purchase the goods from the sales person directly hired by the manufacturer, the consumer is entitled to return the goods and get the purchase price refunded within 30 days after the purchase, provided that the goods have not been unpacked.
- (ii) Pursuant to Shanghai’s local rules regarding consumer protection, if the consumer purchases goods under a door-to-door marketing, the consumer is entitled to return the goods and get the purchase price refunded within seven days after the purchase without any reasons.
- (d) **Other Noteworthy Rights of Consumers Regarding Receivables**

It is noteworthy that, the seller’s rights to claim for consumer’s payment of receivables would be subject to the statutory limit generally applicable to all civil rights, for instance, under an international sale of goods, if the seller fails to claim for the consumer’s payment of the purchase price within four years after the due date, such receivables would not be protected by the People’s Court any more.

---

### 1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

---

PRC laws do not provide different requirements for the sale or collection of government receivables generated under a commercial transaction. However, it is notable that, under PRC laws, all the payments to be made by the government or a government agency shall be included in the annual budget of central government or local government, which shall be approved by the People’s Congress of the corresponding level.

## 2 Choice of Law - Receivables Contracts

### 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in the PRC that will determine the governing law of the contract?

In the absence of choice of law in a receivables contract, the main principles for determining the governing law will differentiate between domestic transactions and foreign-related transactions.

If the transaction is a purely domestic transaction, PRC law could be the only governing law to the contract.

If the transaction is a foreign-related transaction, according to the *PRC Laws on Governing Law of Foreign-related Civil Relationship* effective from 2011, the governing law can be determined based on the principles of “country of the party with characteristic performance” and “country most closely connected”.

### 2.2 Base Case. If the seller and the obligor are both resident in the PRC, and the transactions giving rise to the receivables and the payment of the receivables take place in the PRC, and the seller and the obligor choose the law of the PRC to govern the receivables contract, is there any reason why a court in the PRC would not give effect to their choice of law?

No. There is no reason why a PRC court would not give effect to the parties’ choice of law under such circumstances.

### 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in the PRC but the obligor is not, or if the obligor is resident in the PRC but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in the PRC give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Pursuant to the *PRC Laws on Governing Law of Foreign-related Civil Relationship* and the Supreme Court’s interpretation thereto issued in 2012, the above situation would enable the receivables contract to be deemed as a contract with a “foreign element”, and the PRC court would generally give effect to the choice of foreign law.

The above general principle will not apply under the following circumstances:

- PRC laws have mandatory principles of law for this type of contract. For instance, a contract in respect of real estate shall be governed by laws where the real estate is located, and a Sino-foreign joint venture contract shall be mandatorily governed by the PRC law, etc.; and
- choosing foreign law as the governing law will jeopardise the public interest of the PRC, in which case PRC law shall be the governing law.

---

### 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in the PRC?

---

PRC acceded to the CISG in December 1986. When acceding to the CISG, PRC made two reservations for Item (b) of Paragraph 1, Article 1 and Article 11. However, PRC’s reservation to Article 11 was retrieved in 2013.

## 3 Choice of Law - Receivables Purchase Agreement

### 3.1 Base Case. Does PRC law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., PRC laws or foreign laws)?

No, PRC law does not require the sale of receivables to be governed by the same law as the law governing the receivables themselves.

### 3.2 Example 1: If (a) the seller and the obligor are located in the PRC, (b) the receivable is governed by the law of the PRC, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of PRC to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the PRC, will a court in the PRC recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Due to the foreign exchange control in the PRC, a PRC seller is not able to sell the receivables generated from a PRC obligor to an offshore purchaser.

Purely from the choice of law perspective, a PRC court would recognise the choice of PRC law to the receivables purchase agreement (“RPA”).

**3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside the PRC, will a court in the PRC recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?**

A PRC court recognises the choice of PRC law and recognises the sale as being effective against the seller, the obligor and other third parties, provided that the relevant requirements under the PRC law for the sale have been complied with.

The foreign law requirements of the obligor’s country or the purchaser’s country (or both) may apply with respect to enforcement actions against the obligor or the purchaser, as applicable.

**3.4 Example 3: If (a) the seller is located in the PRC but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in the PRC recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with PRC’s own sale requirements?**

The principles regarding the recognition of the choice of foreign law governing the sale of the receivables, as discussed in questions 2.3 and 3.1, will apply.

Assuming the sale is effective against the seller and other third parties in the PRC pursuant to its governing law, a PRC court will recognise the sale as being effective against the seller and such other third parties, provided that:

- (a) mandatory rules and requirements under PRC law must be complied with if, and to the extent that, they are applicable. For instance, due to foreign exchange control, the seller may be subject to the authenticity verification imposed by foreign exchange authority for its sale of receivables to purchaser; and
- (b) when bringing enforcement actions against the seller before a PRC court, the rules regarding enforcement of foreign court judgment or arbitration awards will apply.

**3.5 Example 4: If (a) the obligor is located in the PRC but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in the PRC recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with the PRC’s own sale requirements?**

See the answer to question 3.4 above.

**3.6 Example 5: If (a) the seller is located in the PRC (irrespective of the obligor’s location), (b) the receivable is governed by the law of the PRC, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in the PRC recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in the PRC and any third party creditor or insolvency administrator of any such obligor)?**

If the obligor is located in the PRC, as stated in question 3.2, due to the foreign exchange control in the PRC, a PRC seller is not able to sell the receivables generated from a PRC obligor to an offshore purchaser.

If the obligor is located in a country other than PRC, see question 3.4 above.

## 4 Asset Sales

**4.1 Sale Methods Generally. In the PRC what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

Sale of receivables is deemed as an assignment of contract rights under the *PRC Contract Law*. The *PRC Contract Law* stipulates that a creditor may assign its rights under a contract to a third party, subject to any transfer restrictions contained in the original contract or otherwise stated in the PRC law.

The customary terminology in the PRC for the sale of receivables is “assignment”.

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

A sale of receivables will generally be deemed as completed between the seller and the purchaser upon the execution of a RPA. Pursuant to the *PRC Contract Law*, the assignment of contract rights by a creditor will become effective against the obligor once a notice of assignment has been serviced to the obligor.

PRC laws do not request additional or other formalities for the sale of receivables to be perfected against any subsequent good faith purchasers. Although the PBOC has established an online registration system for the pledge of account receivables, which also opens for registration of sale of receivables, such sale of receivables registration has not been vested with a public announcement function by law to claim against *bona fide* third party purchasers.

It is notable that, where the sale of receivables involves the transfer of security interest attached to the assigned receivables, the answers to questions 4.3 and 4.11 will apply. Furthermore, where the receivables are generated under a cross-border transaction, or the sale of receivables will cause conversion of RMB to foreign currency, the answer to question 8.5 will apply.



**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

Under the *PRC Instruments Law*, promissory notes are deemed as on-demand payment instruments and can only be issued by commercial banks. Transfer of promissory notes will request the endorsement from issuer or holder, as the case may be, and delivery of the same to the purchaser.

In respect of mortgage loans, according to the *PRC Property Rights Law* and *PRC Security Law*, the mortgage rights enjoyed by the seller can be transferred together with the secured indebtedness, but the mortgage rights in favour of the purchaser shall be registered with the relevant registration authority.

The sale of consumer loans will not be subject to additional or deferent sale or perfection requirements, in addition to question 4.2.

The sale of marketable debt securities issued in the public market, such as bonds and notes, shall be conducted through the applicable clearing agency, such as China's Securities Depository and Clearing Corporation Limited (for bonds traded on the stock exchange) and China's Government Securities Depository Trust & Clearing Co. Ltd. (for notes traded on the National Inter-bank Market).

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

According to the *PRC Contract Law*, the assignment of contract rights by a creditor will become effective against the obligor once a notice of assignment has been served to the obligor.

The obligor's consent for the sale of receivables is normally not required for the sale to be an effective sale against the obligor unless expressly required under the receivables contract.

If the receivables contract remains silent on the seller's assignment of receivables to a third party, a notice instead of consent from the obligor is sufficient. However, if the receivables contract expressly prohibits assignment, then a separate consent from the obligor will be required to validate the transfer.

The notice to the obligor could make the sale of receivables effective against the obligor, and will give rise to certain benefits to the purchaser, as follows:

- the obligor will not be able to claim for set-off rights against the seller entitled to the obligor after the service of the notice;
- the obligor must make payments as directed by the purchaser and the obligor can no longer discharge its obligations by making payment to the seller;
- enforcement actions may be taken by the purchaser against the obligor directly without involving the seller; and
- depending on the content of the receivables contract and notice, the obligor and the seller may no longer amend the underlying receivables contract.

Having said that, the notice will not cut-off the obligor's existing rights against the seller under the receivables contract, such as claiming for the seller's non-performance of its obligation.

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

There are no requirements regarding the timing of service of the notice to the obligor, nor are there any requirements regarding the form a notice must take or how the notice must be delivered in order for the notice to be legally valid and effective under PRC law. In practice, a notice of assignment will generally be made in written form and include a request for an acknowledgment of the assignment (or, where applicable, a consent to the assignment) by the obligor for evidence purposes, and the notice is served to the obligor on, or immediately after, the sale.

There is no time limit beyond which the delivery of notice would become ineffective. A notice may be delivered to the obligor regardless of whether an insolvency proceeding has commenced against the obligor. However, it is strongly suggested that notice be sent before the insolvency proceedings against the seller commences.

A notice may relate to all, or only part of, the existing receivables between the obligor and the seller, and subject to the answer to question 4.10.

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?**

Yes. Both restrictions prohibit the seller from transferring its rights and obligations to a third party without the obligor's consent.

**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in the PRC? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If the PRC recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

Such restrictions are generally enforceable in the PRC, and we are not aware of any exceptions to this rule.

If the seller sells the receivables to the purchaser irrespective of the prohibitions in the receivables contract, it is the seller who will be

liable to the obligor for breach of contract. Under such circumstances, the sale will not be effective against the obligor unless its consent is obtained.

---

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

---

Under PRC law, a sale document must provide sufficiently specific descriptions of the receivables to be sold so that they are capable of being identified at the time of the assignment. This does not necessarily require that each receivable has to be separately identified.

There is no legal requirement on what specific information is required, but in practice, in order to make the receivables identifiable, some basic information such as obligor's name, invoice date, payment date, etc., needs to be stated. The receivables being sold do not necessarily need to share objective characteristics.

A statement that the seller sells all of its receivables to the purchaser is unlikely to be deemed as sufficient identification of receivables, nor will a statement that the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors be deemed as sufficient.

---

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

---

As discussed in question 4.1, the sale of receivables is to be carried out by way of assignment of contract rights. As a general contract law principle, a PRC court would generally respect the parties' intent to honour a transaction as an assignment of contract rights. However, in certain circumstances, the PRC court may still enquire into the economic characteristics of the transaction, for example:

- (a) There is no receivables contract or the receivables contract is null and void. According to the *PRC Contract Law*, a contract may be deemed as null and void under the following situations:
  - (i) it is concluded through the use of fraud or coercion by one party to jeopardise the interests of the State;
  - (ii) malicious collusion is conducted to jeopardise the interests of the State, a collective or a third party;
  - (iii) an illegitimate purpose is concealed under the guise of legitimate activities;
  - (iv) damage to the public interest; or
  - (v) violation of the compulsory provisions of laws and administrative regulations.

Under such circumstances, the court may enquire into the economic characteristics of the assignment. Where the court found that the purchaser has already known the non-existence or invalidity of the receivables contract when entering into the assignment with the seller, the purchaser is likely to be deemed as granting loans to the seller.

- (b) The RPA is ambiguous in respect of the assignment of receivables.
- (c) The assignment of the receivables by the sellers is not a normal and fair sale with reasonable consideration and constitutes a gratuitous assignment by the sellers of its proprietary rights, or an abnormal under-sale of its assets, or an abandonment of its creditor's rights. Under such circumstances, the assignment, sale or abandonment shall be null and void if, according to the *PRC Enterprise Bankruptcy Law*, such act occurs during the period commencing within one year prior to the acceptance by the People's Court of the bankruptcy case of the seller.
- (d) Where the assignment of receivables is made on the condition that the seller will retain credit risk of the receivables, such assignment is very likely to be re-characterised as a loan.
- (e) Pursuant to the China Banking Regulatory Commission ("CBRC")'s notice issued in 2009, when a banking institution assigns its credit assets, it shall not retain the credit risks of the credit assets to be assigned, nor is it allowed to retain right of repurchase/redemption thereof.

Subject to the above, to our general understanding, where the seller retains interest rate risks and/or control of collection of receivables, the assignment of receivables is unlikely to be jeopardised.

---

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

---

PRC laws do not squarely deal with this issue. To our general experience, the following requirements need to be followed in order to make such continuous assignment of receivables enforceable (prior to the sellers' insolvency):

- (a) the RPA has clearly stated the parties' intention of continuous assignment of receivables; and
- (b) the receivables shall be identifiable. See our answer to question 4.7.

---

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?**

---

There is no clear legal basis under PRC law for the enforceability of a current transfer of future receivables before the seller's insolvency. General understanding is, if (a) the future receivables arise from presently-existing receivables contract, and (b) the seller has already performed its major obligations (such as delivery of goods with agreed quantity and quality), and (c) proper notice has been served to the obligor, the present sale of receivables is unlikely to be challenged.

Where the seller goes into bankruptcy, according to the *PRC Enterprise Bankruptcy Law*, the administrator would have the

power to reject or continue to perform any pre-petition executory contracts.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

The nature of the assets constituting the related security will determine the additional formalities, if any, applicable to the transfer. According to the *PRC Property Rights Law* and *PRC Security Law*, the formalities applicable to transfer of security could be categorised as follows:

- (a) for those mortgages which are established upon the execution of a written mortgage agreement and registration of the same of registries designated for each type of specified property, such as land use rights, urban real estate, buildings, etc., mortgage rights may be transferred together with the secured indebtedness only by re-registration of the mortgage in favour of the new mortgagee;
- (b) for those mortgages which are established upon the execution of a written mortgage contract, but are not effective against third parties unless registered, such as aircraft, moveable property, etc., mortgage rights may be transferred together with the secured indebtedness by assignment, however, the transfer would not be effective against third parties unless the mortgage is re-registered in favour of the new mortgagee;
- (c) for pledges of moveable assets, which are established by execution of a written pledge contract and delivery of possession of the pledged object to the pledgee, the pledge rights may be transferred together with the secured indebtedness by assignment and re-delivery of the possession of the pledged assets to the pledgee;
- (d) for the pledges of rights, which are established by execution of a written pledge contract and delivery of possession of rights documents, such as draft, promissory notes, cheques, bonds in the form of definitive note, depository notes, warehouse receipts, bill of lading, and pledge rights may be transferred together with the secured indebtedness only by execution of a new pledge contract and endorsement on and/or delivery (as the case may be) of the rights documents to the new pledgee; and
- (e) for the pledge of rights, which are established by execution of a written pledge contract and registration with relevant registration agencies, such as securities, equity interest, IP rights, receivables, etc., pledge rights may be transferred together with the secured indebtedness only by execution of a new pledge contract and re-registration of the pledge in favour of the new pledgee.

In addition, where the creation of the existing security also involves other government authorities' approval/registration process, for instance, mortgage/pledge of bonded warehouse goods would request the approval from customs, and security in favour of offshore creditor requests approval and/or registration from the State Administration of Foreign Exchange ("SAFE"), the transfer of such security interest shall also be subject to re-approval by and/or re-registration with relevant original approving/registration authorities.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

No. Under the *PRC Contract Law*, the obligor may set-off the receivables against the amount the seller owes to it when the obligor receives the notice of assignment of the receivables provided that the latter amount is due at the same time as, or prior to that of, the receivables.

The *PRC Contract Law* is silent on when the obligor's right of set-off terminates, but it appears that if the obligor does not claim such right promptly after it receives such notice, such right will terminate. Under such circumstances, neither the seller nor the purchaser is liable to the obligor for the termination of the set-off right.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in the PRC to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

There is no such concept as "back-up security" under PRC law.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of the PRC, and for such security interest to be perfected?**

This is not applicable in the PRC.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in the PRC to grant and perfect a security interest in purchased receivables governed by the laws of the PRC and the related security?**

According to Article 228 of the *PRC Property Law*, the pledgor and the pledgee shall sign a written contract for the pledge of receivables. The pledge over receivables comes into effect when the pledge has been duly registered with the Credit Reference Centre ("CRC") of the PBOC.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of the PRC, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in the PRC or must additional steps be taken in the PRC?**

The security interest will not be perfected under PRC law and registration with the CRC as mentioned in question 5.3 must be made in the PRC.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

There are no definitive rules with additional requirements applying to security interests in, or connected to, insurance policies under PRC law.

A security interest in promissory notes may be created by way of a pledge. Article 224 of the *PRC Property Rights Law* stipulates that the pledgor and the pledgee shall draw up a written contract for the pledge and such security interest shall be created upon the delivery of the pledged promissory note to the pledgee. In addition, pursuant to Article 98 of the *Judicial Interpretations of the PRC Security Law*, the promissory note shall be endorsed on the reverse side with the word “pledge” in order to be enforceable against a *bona fide* third party. Therefore, delivery and endorsement are the statutory requirements to create a perfect pledge on promissory notes.

A security interest in marketable debt securities, such as bonds, may also be created by way of a pledge. The pledgor and the pledgee shall enter into a written contract and such security interest shall be created upon the delivery of the certificate of marketable debt securities to the pledgee if it is in the form of definitive note. Moreover, pursuant to Article 99 of the *Judicial Interpretations of the PRC Security Law*, the certificate shall be endorsed on the reverse side with the word “pledge” in order to be enforceable against a *bona fide* third party. In case there is no definitive certificate, the pledge rights shall be created upon the registration of such pledge at relevant authority. The relevant depository and clearing institutions refer to the China Securities Depository and Clearing Corporation Limited or Shanghai Clearing House in the case that marketable debt securities are traded on the stock exchange, or China Government Securities Depository Trust & Clearing Co. Ltd. in the case that the marketable debt securities are traded on the National Inter-Bank Market.

PRC law is silent on whether security interest could be created over the mortgage loans or consumer loans or not.

**5.6 Trusts. Does the PRC recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Trusts are recognised under PRC law. However, the trust in the PRC is usually in a form of special purpose trust. A CBRC-licensed trust company operates as the trustee and administers the trust assets for the benefits of beneficiaries. A PRC court may not give effect to collection trust in relation to receivables which is conducted by virtue of “hold on trust” or “trust declaration”. Before the monies turned over to the purchaser, the monetary proceeds held by the seller constitute the seller's asset, therefore there stands the comingling risk if the seller goes bust. Nonetheless, if the purchaser has paid off the purchase price and the collections are deposited separately and apart from the seller's other assets, in practice the PRC courts may probably permit the purchaser to get the collections back even if the seller is insolvent.

**5.7 Bank Accounts. Does the PRC recognise escrow accounts? Can security be taken over a bank account located in the PRC? If so, what is the typical method? Would courts in the PRC recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in the PRC?**

Escrow accounts are recognised and widely used in the PRC.

Except that the pledge created by a bank as the pledgee over export tax rebate accounts is recognised by the PRC Supreme People's Court in accordance with the *Provisions of Relevant Issues Concerning the Trial of Cases Involving Loans Pledged with an Export Tax Rebate Custodian Account* promulgated by the Supreme People's Court on 22 November 2004, there is no concept of the security over a bank account under PRC law.

Bank accounts are not considered a type of property explicitly recognised by PRC law as pledgeable assets. Instead, cash is, in general, characterised as a special type of movable asset and the pledge is explicitly recognised under PRC law. The general rule under the *PRC Security Law* is that no pledge may be created over future funds in bank accounts. Funds in a bank account for a pledge shall be ascertained and identified at the time of perfection of the pledge. Pursuant to Article 85 of the *Judicial Interpretations of the PRC Security Law*, the cash may be delivered to the creditor in its possession as security for the performance of an obligation, and the creditor may have priority in applying such cash towards the satisfaction of an obligation owed to the creditor, if the cash is “fixed” in the form of special accounts (i.e. the parties have to specify the account as well as the cash balance standing to the credit of such an account).

Any cash flow in or out after the account has been fixed will require the pledgor to re-issue a pledge notice/confirmation specifying the updated cash balance. Such confirmation letter shall be issued each time a change occurs to the account balance. Otherwise, the pledge will no longer be valid under PRC law.

We noticed a few precedents that the security governed by foreign-law over a PRC account was recognised by PRC court. PRC is not a common law jurisdiction. Case precedent might not be recognised by other courts.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

Not applicable to bank accounts other than export tax rebate custodian accounts. In respect of the export tax rebate custodian account, according to the *Provisions of Relevant Issues Concerning the Trial of Cases Involving Loans Pledged with an Export Tax Rebate Custodian Account*, the pledgee may, to the extent of the outstanding secured debt, apply all the funds in the pledged bank account to discharge such debt.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

This is not applicable to bank accounts other than an export tax rebate custodian account. In respect of the export tax rebate custodian account, the owner of the account could not access the

funds in the export tax rebate account unless the pledgee agrees to release the funds in the account in whole or in part.

## 6 Insolvency Laws

**6.1 Stay of Action.** If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will PRC insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

After a sale of receivables that is otherwise perfected, and provided that the sale of receivables is not subject to any situations as stated in question 4.8 and the clawback discussion in question 6.3, the rights of a purchaser made in good faith will remain unaffected by subsequent insolvency proceedings of a seller. However, the situation would be different if:

- (a) The purchaser is deemed to only be a secured party with respect to the receivables. In such circumstances, according to the *PRC Enterprises Bankruptcy Law*, a moratorium would apply to all creditors (secured and unsecured) upon the filing and acceptance by the PRC court of a petition of insolvency in respect of the seller. The moratorium would last until an order of insolvency and liquidation issued by the PRC court. During the moratorium, the secured creditor would be stayed from enforcing its security. Upon liquidation of the seller’s estate, a secured creditor would have priority over all unsecured creditors (other than statutory preferential creditors) over the property secured.
- (b) The seller goes into insolvency after it has executed the RPA with the purchaser but neither party has completed the performance of such agreement. Under such circumstances, the bankruptcy administrator will have the right to determine whether to terminate or to continue to perform such agreement. If the bankruptcy administrator fails to notify the purchaser within two months of the acceptance of any bankruptcy petition in respect of the seller, or fails to reply within 30 days of receipt of a purchaser’s demand to make such a decision, such agreement shall be deemed to be terminated. If the bankruptcy administrator determines to continue to perform such agreement, then the purchaser shall perform such agreement, provided that the purchaser has a right to require the bankruptcy administrator to provide a guarantee for such performance. The agreement would be deemed to be terminated if the bankruptcy administrator refuses to provide a guarantee.
- (c) The seller goes into insolvency after it has executed the RPA with the purchaser but the seller has not fully performed its obligations under the underlying receivables contract. Under such circumstances, subject to the same bankruptcy administrator’s decision process as mentioned in (b) above, the bankruptcy administrator will have the right to determine whether to terminate or to continue to perform such contract.

If the bankruptcy administrator determines to continue to perform such receivables contracts, then the purchaser’s rights under the RPA would not be affected.

On the contrary, if the bankruptcy administrator refuses to continue to perform such receivables contract, the receivables contract would be terminated accordingly. In that case, the purchaser is only entitled to ask the underlying obligor for those receivables in

relation to the obligations that have already been performed by the seller, whilst for the purchase price and damage corresponding to the rest of the parts, the purchaser may only be able to claim through distribution of bankruptcy property as an ordinary creditor of the seller.

**6.2 Insolvency Official’s Powers.** If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

This is not applicable in the PRC.

**6.3 Suspect Period (Clawback).** Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in the PRC for (a) transactions between unrelated parties and (b) transactions between related parties?

The transactions between the seller and its related or unrelated parties will be subject to the same principle of clawback.

Article 16 of the *PRC Enterprise Bankruptcy Law* restricts any payments from the debtor to its creditors once the court has accepted the bankruptcy petition in relation to the debtor. The bankruptcy administrator also has the right under Article 32 of the *PRC Enterprise Bankruptcy Law* to request the court to revoke any preferential payments made by the bankrupted entity within the six-month period prior to the court’s acceptance of the bankruptcy petition, unless those payments benefit the bankrupted entity’s assets.

Under Article 31 of the *PRC Enterprise Bankruptcy Law*, the bankruptcy administrator has the right to request the court to revoke any of the following acts relating to the debtor’s assets to the extent occurring within one year prior to the court’s acceptance of the bankruptcy petition: (a) transferring the property gratis; (b) trading at an obviously unreasonable price; (c) providing property guaranty to unsecured debts; (d) paying off debts not due; or (e) abandoning claims.

**6.4 Substantive Consolidation.** Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

There is no concept of substantive consolidation in the PRC.

**6.5 Effect of Proceedings on Future Receivables.** If insolvency proceedings are commenced against the seller in the PRC, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

Subject to the answers to question 4.10 regarding the recognition of future receivables, our discussion in question 6.1 (b) and (c) will apply.

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

Since under the limited recourse provision, the recourse of the creditor is limited to the available assets of the debtor and if there is any shortfall the debt will be extinguished, it seems unlikely that the debtor will be declared on such grounds.

## 7 Special Rules

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in the PRC establishing a legal framework for securitisation transactions? If so, what are the basics?**

Since 2005, the PRC regulatory authorities and the market participants worked out two possible securitisation structures, i.e. special-purpose trust structure ("SPT Structure") and specific asset management plan structure ("SAMP Structure").

**SPT Structure** – the SPT Structure is broadly used by financial institutions under the jurisdiction of the CBRC (particularly, banks and auto finance companies) to package their credit portfolio into asset-backed securities traded in the National Inter-bank Bond Market ("NIBBM"). In 2005, credit portfolio asset securitisation started with the successful debut of two pilot transactions launched respectively by the China Development Bank ("CDB") and the China Construction Bank ("CCB"). These two deals were made possible after years of joint efforts by multiple government bodies led by the CBRC and the PBOC. Upon closing of the first two pilot transactions, the PBOC and the CBRC jointly issued the *Administrative Measures on Pilot Projects for Securitisation of Credit Assets Procedures* on 20 April 2005. In addition, the CBRC further released the *Measures for the Supervision and Administration on Pilot Securitisation Projects of Credit Assets of Financial Institution* to set out detailed requirements and procedures for the ABS products with SPT Structure. After a series of legal frameworks had been well set up, the CBRC issued another round of pilot approvals for securitisation projects across a range of underlying asset pools including residential mortgages, auto loans, SME loans and non-performing loans. By the end of 2008, 11 banks and financial institutions issued ABS in the two rounds of approvals, with a total value of RMB 67 billion. On 17 May 2012, the PBOC, the CBRC and the Ministry of Finance ("MOF") released the *Notice on Matters Regarding Further Expansion of Credit Asset Securitisation Pilot Projects* ("Pilot Notice"), whereby the Chinese regulators announced a quota of RMB 50 billion for this new round of credit assets securitisation transactions in the PRC. According to the Pilot Notice, no re-securitisation or complex synthetic products will be encouraged by the regulatory authorities, the senior tranche of ABS have to be reviewed and rated by at least two credit rating agencies, and the originators are now required to retain a certain portion of the junior tranche (in principle, no less than 5 per cent of the total issued securities). Furthermore, the investment by one single investor should be capped within 40 per cent of the total issuance.

**SAMP Structure** – Running in parallel with the ABS under SPT Structure (which is designed specifically for financial institutions), the SAMP Structure was brought to the PRC market in May 2005 under an interim rule, *Administrative Measures for Securitisation Business by Securities*, constituted by the China Securities Regulatory Commission ("CSRC"). Furthermore, on 15 March 2013, CSRC further released the *Administrative Measures on Securitisation Business of a Securities Company* ("SAMP Rules"). According to the

SAMP Rules, a securities firm launches a SAMP to issue certificates in the stock exchange (i.e., Shanghai Stock Exchange and Shenzhen Stock Exchange) to raise funds from investors. Upon completion of the offering, the SAMP will invest the proceeds in return for a specific, predominantly corporate asset with a sustainable and predictable cash flow. The scheme provides a return to the investors through a dedicated bank account. Similarly to a typical securitisation transaction, under the SAMP structure, cash flows from the asset will be the main source for repayment of principal and interest to investors. For credit enhancement, the external guarantor or liquidity supporter will be standby and top up the cash flow or provide certain liquidity facility in case of any shortfall.

**7.2 Securitisation Entities. Does the PRC have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

Other than the trust scheme for SPT Structure and the specific asset management plan for SAMP Structure, PRC law is silent on the set-up of a special purpose vehicle in other form for securitisation.

**SPT Structure** – the trust plan as a special purpose trust will be used as a vehicle to hold the legal title to the underlying assets, which constitute the trust assets. The SPT managed by the trustee (i.e. the CBRC-regulated trust company) is not a legal person under PRC law and the disposal and utilisation of all the trust assets will be managed in the name of the trustee. There is no corporate governance requirement in respect of the SPT. For the decision-making procedure, usually the trust document will specify the matters and circumstances subject to the approval of all or majority beneficiaries, the rest will be at the discretion of the trust company in a fiduciary capacity.

**SAMP Structure** – just as the SPT, the specific asset management plan is also not recognised as a legal person under PRC law. When setting up the SAMP, the investor entrusted the money into the SAMP, the securities company as manager of the SAMP will utilise the raised money to invest in the underlying asset. In comparison with the SPT, SAMP is less advanced in terms of legal integrity, tax neutrality and accounting clarity, a situation which in turn might affect its ability to achieve true sale and bankruptcy remoteness.

**7.3 Limited-Recourse Clause. Will a court in the PRC give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

A limited-recourse clause is an enforceable contractual arrangement under PRC law.

**7.4 Non-Petition Clause. Will a court in the PRC give effect to a contractual provision in an agreement (even if the agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

PRC law does not expressly prohibit or restrict a non-petition clause, and we believe it will impose enforceable obligations on a

party who makes a non-petition undertaking. However, there is a theoretical argument that the rights of claim conferred upon by the PRC laws and regulations may not be waived by the provisions contained in the agreement, and to our knowledge, such non-petition clause has not been tested in a PRC court.

**7.5 Priority of Payments “Waterfall”. Will a court in the PRC give effect to a contractual provision in an agreement (even if the agreement’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

A PRC court will generally give effect to a contractual provision on payment distribution based on the principle of freedom of contract.

**7.6 Independent Director. Will a court in the PRC give effect to a contractual provision in an agreement (even if the agreement’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

A PRC court generally may give effect to a contractual provision or a provision in a party’s organisational documents prohibiting the directors from taking specified actions without the affirmative vote of an independent director. However, in the PRC, the shareholder can convene a shareholding meeting to decide the filing of bankruptcy of the company without any proposal from board level. As such, the independent director’s vote cannot block the resolution of shareholders in respect of bankruptcy filing.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in the PRC, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in the PRC? Does the answer to the preceding question change if the purchaser does business with other sellers in the PRC?**

Merely owning receivables and collecting and enforcing receivables will not result in an offshore purchaser being subject to financial licence requirements.

Notwithstanding the above, if the purchaser is to establish a business existence in the PRC for receivables purchase business, according to the relevant regulations issued by the Ministry of Commerce in 2012, it may be deemed as engaging in commercial factoring business, which will in turn give rise to approval from the Ministry of Commerce. For your information, currently the foreign investment in commercial factoring is still under trial, and the foreign invested commercial factoring companies are only allowed to be established in Shanghai, Tianjin, Shenzhen and Guangzhou.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

The seller may, without any licence, continue to enforce and collect receivables after the completion of the sale to the purchaser.

A third party replacement servicer may, or may not, require any licence to enforce and collect sold receivables depending on the nature of the underlying assets.

**8.3 Data Protection. Does the PRC have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

The *PRC Contract Law* requires parties to a contract to act in good faith and perform obligations such as maintaining confidentiality in accordance with the nature and purpose of the contract and/or trade usage. Parties to the contracts must comply with this general principle of confidentiality.

The *Interim Provisions on the Protection of Trade Secrets of Central Enterprises*, promulgated by the State-owned Assets Supervision and Administration Commission on 25 March 2010 classifies customer information as one of the trade secrets owned by the central State-owned enterprises. It also requires such enterprises to enter into a confidentiality agreement with the counterparty when dealing with customer information and other trade secrets.

Where the seller is a financial institution licensed by CBRC, the seller will be subject to general confidentiality requirements applicable to financial institutions. In particular, according to a notice issued by the PBOC’s in 2011 (YIN FA 2011 No. 17), banking institutions in the PRC are not allowed to provide any information regarding individual consumers to any offshore entities or individuals.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of the PRC? Briefly, what is required?**

See our discussion in question 1.2.

**8.5 Currency Restrictions. Does the PRC have laws restricting the exchange of the PRC’s currency for other currencies or the making of payments in the PRC’s currency to persons outside the country?**

Yes, the PRC imposes strict controls on both convertibility and transferability of the RMB, which is mainly governed by *PRC Foreign Exchange Regulations* and various rules and notices issued by the State Administration of Foreign Exchange (“SAFE”).

A new tendency regarding the payment of RMB outside the PRC is, starting from 2009, that the PBOC launched a RMB internationalisation scheme, under which PRC entities are allowed to make payment of RMB to persons outside the PRC for international trade settlement.

## 9 Taxation

### 9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in the PRC? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?

PRC withholding taxes may be imposed depending on the nature of the receivables and the location of the seller and purchaser.

Interests and royalties (including also royalties for the use of the industrial and commercial equipment) sourced from the PRC and derived by a seller or purchaser being a non-tax resident will be subject to a withholding tax at the rate of 10 per cent. The tax rate may be reduced or exempted by the applicable double tax treaty. The obligors are obliged to withhold and settle the withholding tax with the PRC tax authority for the seller or purchaser.

Provided that the seller or the purchaser is domestically incorporated, there would be no PRC withholding taxes imposed on the payment on receivables made by a PRC obligor to the seller or purchaser.

The risk needs to be evaluated on a case-by-case basis and largely depends on the discretion of the relevant tax authorities.

### 9.2 Seller Tax Accounting. Does the PRC require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

There is no express accounting policy in the PRC adopted by the seller and purchaser for tax purposes in the context of a securitisation. The seller shall comply with the *China Accounting Standard for Enterprise No. 23 - Derecognition of Financial Assets* ("CAS No. 23"). CAS No. 23 was published by the MOF in 2006 and replaced the former circular *Accounting Provisions of Credit Assets Securitisation*.

According to the circular of *Relevant Taxation Policy Issues Relevant to the Securitisation of Credit Assets* (Caishui [2006] No. 5), the originator shall realise its gains and losses derived from the sales of credit assets in a securitisation of credit assets in accordance with *PRC Corporate Income Tax Law* and settle the Corporate Income Tax ("CIT") accordingly.

### 9.3 Stamp Duty, etc. Does the PRC impose stamp duty or other documentary taxes on sales of receivables?

The agreement for sales of receivables does not fall into the categories of taxable documents, and thus will not be subject to any Stamp Duty.

### 9.4 Value Added Taxes. Does the PRC impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

The sales of taxable goods and the provision of labour services in relation to the processing of goods and of repair and replacement services within the PRC are subject to Value Added Tax ("VAT"). The VAT rate ranges from 0 per cent to 17 per cent. The standard rate is 17 per cent.

Business Tax ("BT") applies to the provision of services (excluding processing services and the repair and replacement services). It also applies to the transfer of intangible assets such as goodwill, patents and the sale of real estate properties in the PRC. BT rates range from 3 per cent to 20 per cent. BT and VAT are mutually exclusive.

The service fee received by the collection agent shall generally be subject to BT. Normally, the sales of receivables are not taxable with regard to both VAT and BT. However, the MOF and State Administration of Taxation jointly issued two circulars in 2011, officially kicking off the transformation of BT to VAT ("Transformation") for the service industry. According to the two circulars, depending on the nature of the receivables, certain categories of service previously imposed by BT may now be subject to VAT (e.g. financial leasing sector). Thus the sales of receivables in relation to such services technically may also be subject to VAT. Given the Transformation is still in a state of flux, the practice of turnover tax implications of the sales of receivables may vary in different locations.

### 9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

If the tax authority deems the sale of receivables to be taxable from the VAT perspective under the new VAT scheme after the Transformation, the seller would be the taxpayer and shall undertake the obligations of filing and settling the VAT. It is not likely that the tax authority would be able to claim unpaid taxes against the purchaser or against the sold receivables, unless the receivables are considered by the tax authority to have been sold with no consideration or with an unreasonable price, under which the tax authority is entitled to petition a court to revoke such sale of receivables.

### 9.6 Doing Business. Assuming that the purchaser conducts no other business in the PRC, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in the PRC?

According to the *PRC Corporate Income Tax Law*, if the purchaser is not a PRC resident for tax purposes, it is taxed only on its PRC and foreign sourced income that is attributable to their establishments or places of business in the PRC, which shall be assessed depending on various factors (including the nature of receivables, the activities undertaken by the purchaser in the PRC, etc.). If there is a double tax treaty between the PRC and the country (or region) where the purchaser is located, the provisions of such treaty shall prevail.

Assuming the purchaser is located outside the PRC, generally the purchaser will not be liable to tax in the PRC from the CIT perspective provided that its activities are limited only to purchasing receivables, appointing the seller as its servicer and collection agent, or enforcing against the obligors and it conducts no other business in the PRC, unless such activities undertaken by the purchaser constitute a permanent establishment as prescribed by the applicable double tax treaty. Please refer to questions 9.3 and 9.4 above for the implications of turnover taxes and Stamp Duty.



**Roy Zhang**

King & Wood Mallesons  
17th Floor, One ICC  
Shanghai International Commerce Centre  
999 Middle Huai Hai Road  
Xuhui District, Shanghai 200031  
P. R. China

*Tel:* +86 21 2412 6053  
*Fax:* +86 21 2412 6350  
*Email:* roy.zhang@cn.kwm.com  
*URL:* www.kwm.com

Roy Zhang is a Partner based in Shanghai and Hong Kong and specialises in debt capital markets, structured finance and private finance.

Roy concentrates his practice principally in the areas of both debt and equity financing transactions with an emphasis on leveraged financing, structured financing and technology focused industries. He represents commercial and investment banks, private equity, venture capital investors, industrial sponsors, and private and public companies, in all aspects of complex business transactions, including leveraged buy-outs and financings, strategic mergers, acquisitions and joint ventures, minority equity investments, and debt and equity restructuring. Roy has led transactions in a wide variety of industries including financial services, energy, biotechnology, healthcare, mining and mineral, logistics and transportation, and infrastructure.

**Ma Feng**

King & Wood Mallesons  
40th Floor, East Tower  
World Financial Centre  
1 Dongsanhuan Zhonglu  
Chaoyang District, Beijing 100020  
P. R. China

*Tel:* +86 10 5878 5088  
*Fax:* +86 10 5878 5599  
*Email:* mafeng@cn.kwm.com  
*URL:* www.kwm.com

Ma Feng specialises in banking, domestic and international lending, project finance, establishment projects for financial institutions, and aircraft and equipment financing.

Ma Feng has extensive banking experience. Acting for a wide variety of domestic and foreign banks, he has developed solutions to legal issues in banking and foreign exchange. In domestic and international lending, Ma Feng has participated in numerous loan financing transactions, including: bank financing; syndicate financing; acquisition financing; export credit; and trade financing. Ma Feng has also done extensive project financing work, and has participated in project financing for numerous cross-border investments involving natural resources and infrastructure. Ma Feng has represented clients in investments in and establishment of various financial institutions including commercial banks, financial leasing companies, and car financing companies.

KING & WOOD  
MALLESONS  
金杜律师事务所

With depth in all aspects of structured finance, we have unparalleled experience in securitisation deals both in China and globally. From the beginning of the PRC securitisation in 2005, we have worked on a large number of deals, including some pilot cases in Chinese securitisation history, including the pilot RMBS deal, pilot receivables ABS deal, and pilot auto loan ABS deal. Today, King & Wood Mallesons is recognised as one of the leading Chinese law firms in the area of securitisation transactions, providing a full range of services to our clients.

# Denmark



Kim Toftgaard



Christian Sahlertz

## Accura Advokatpartnerselskab

### 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

(a) No formal requirements are necessary to create an enforceable debt obligation (save for a written requirement in terms of consumer credit agreements, cheques or other special areas of law). An oral or written receivables contract will suffice; however, an oral contract will be difficult to prove. In case of enforcing a debt obligation directly through the bailiff’s court, without obtaining a judgment, the debt obligation must be an instrument of debt including a clause of enforcement. It is not market practice for the buyer to issue an instrument of debt.

(b) An invoice will be sufficient to create an enforceable debt obligation (for the avoidance of doubt, an invoice is not directly enforceable through the bailiff’s court). Formal receivables contracts are not used in Denmark. However, in case the obligor objects to the invoice, it may raise doubts as to the existence of a contract between the parties.

(c) The behaviour between the parties may create a “contract” based on the principle of passivity, practice or customary procedures applicable in such areas of contract law. Furthermore, a historic relationship may create a contract to the extent that there is some form of recording of the debt and the circumstances which gave rise to the debt, and this can be substantiated, if contested by the obligor.

**1.2 Consumer Protections. Do Danish laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

(a) Apart from provisions on usury in the Danish penal code, there are no laws which limit the interest rate that can be charged.

(b) The Danish Interest Rate Act provides creditors with a statutory right to demand default interest on any late payments. The default interest rate is the aggregate of: (i) the lending rate of the Danish National Bank (fixed every half year); and (ii) a margin of 7.00 per cent per annum. In case the credit interest rate exceeds the statutory

default interest rate, the creditors are entitled to apply the credit interest rate as the default interest rate.

(c) The Danish Consumer Credit Act entitles the consumers to discharge payment obligations pursuant to any credit agreements entered into prematurely, either in full or partially. In addition, any credit agreements not limited in time may be cancelled by the consumers from time to time or with one month’s prior notice.

(d) The Danish Consumer Credit Act grants consumers a right to a reduction of costs and expenses in case of premature discharge. In addition, although not specifically aimed at consumers, the Danish Instrument of Debt Act contains provisions which, to some extent, entitle an obligor to exercise rights of set-off even after the receivable has been transferred, *cf.* question 4.4.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

As stated in the answer to question 1.1(b), receivables contracts are not as such used in Denmark. However, any receivable which evidences a debt of the government or a government agency can, in general, be sold to any third party in the same manner as other receivables.

### 2 Choice of Law - Receivables Contracts

**2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Denmark that will determine the governing law of the contract?**

As the receivable would normally only be evidenced by an invoice, the governing law of the invoice would be identical with the governing law of the contract which gave rise to the invoice.

The governing law of the contract giving rise to the invoice will be subject to the EC Convention on Law Applicable to Contractual Obligations (Rome 1980), which has been ratified by, and is in force in, Denmark. Pursuant hereto, the applicable law, in the absence of choice, shall be the law of the country with which it is most closely connected, however, subject to the qualification that the law does not contravene with: (i) Danish public policy (*ordre public*); (ii) international mandatory rules to which the contract has a close connection or the international mandatory rules of Denmark irrespective of the law otherwise applicable to the contract; and (iii) mandatory consumer rules of the country in which the consumer resides.

The EC Regulation on the Law Applicable to Contractual Obligations (Rome I) does not apply to Denmark; *cf.* the Protocol on the position of Denmark in the EU.

**2.2 Base Case. If the seller and the obligor are both resident in Denmark, and the transactions giving rise to the receivables and the payment of the receivables take place in Denmark, and the seller and the obligor choose the law of Denmark to govern the receivables contract, is there any reason why a court in Denmark would not give effect to their choice of law?**

No, a choice of Danish law is valid and will be upheld by the Danish courts in accordance with the EC Convention on the Law Applicable to Contractual Obligations (Rome 1980).

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Denmark but the obligor is not, or if the obligor is resident in Denmark but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Denmark give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

Yes, generally the seller and the obligor may, by way of inclusion of a choice of law clause in the contract, stipulate that foreign law shall govern their contractual relationship, and such choice of law is valid and will be upheld by the Danish courts, subject to the qualification that the foreign law does not contravene with: (i) Danish public policy (*ordre public*); (ii) international mandatory rules to which the contract has a close connection or the international mandatory rules of Denmark irrespective of the law otherwise applicable to the contract; (iii) mandatory consumer rules of the country in which the consumer resides; and (iv) the mandatory laws of any country with which the contract has a significant connection.

Danish public policy is deemed to have little practical meaning as the case law relates to matters which are manifestly incompatible with the public policy of Denmark and is to be applied as a precautionary measure in order to prevent an apparent preposterous result.

**2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Denmark?**

The CISG is fully effective in Denmark since 1 February 2013. The former reservation made in respect of Part II regarding the formation of contracts has now been repealed.

### 3 Choice of Law - Receivables Purchase Agreement

**3.1 Base Case. Does Danish law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Danish laws or foreign laws)?**

No, the parties are free to choose a different law than the law governing the receivables themselves. Unless there are any substantial arguments in favour of the opposite, we recommend that

the parties choose the law that governs the receivables as the governing law of the receivables purchase agreement. In general, there are no obvious benefits from choosing a different law to govern the receivables purchase agreement to the law governing the receivables.

Furthermore, the parties are free to make a single choice of law for, or various choices of law for parts of, the receivables purchase agreement – the latter referred to as *dépeçage*, which is possible only as an exception in case the parties have not specified a choice of law.

**3.2 Example 1: If (a) the seller and the obligor are located in Denmark, (b) the receivable is governed by the law of Denmark, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Denmark to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Denmark, will a court in Denmark recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?**

With regard to examples (1) to (5), Danish law distinguishes amongst the effectiveness of (i) the *inter partes* agreement entered into between the seller and the obligor (or the seller and a purchaser), which is regulated by the EC Convention on the Law Applicable to Contractual Obligations (Rome 1980) as stated above, and (ii) any third party rights which remain unregulated.

Further, according to Danish private international law, any issue regarding the perfection and hence the effectiveness of the sale against third parties must be addressed with reference to the law of the country where the receivable is deemed to be located – referred to as the *lex rei sitae* rule. It is unresolved in Danish law whether a receivable (such being non-negotiable) is located at the obligor's or the seller's domicile as it does not relate to any physical location. There is no decisive case law on the subject and the legal scholars seem to be divided on this question, however, the predominant position is the domicile of the obligor. As a precautionary measure we recommend that the seller (or the purchaser) complies with the perfection requirement in both countries in case they differ.

Consequently, a Danish court will recognise a sale as being effective against third parties if the obligor and the seller are located in Denmark, and provided that the Danish perfection requirements are complied with.

**3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Denmark, will a court in Denmark recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?**

Provided that the perfection requirements under Danish law have been complied with, but a Danish court rules that the perfection requirements shall be subject to foreign law with reference to the obligor's domicile outside Denmark, the sale will not be effective against third parties (if foreign requirements are more extensive).

As a precautionary measure we recommend that the seller (or the purchaser) complies with the perfection requirements in both countries in case they differ.

If the obligor is located in Denmark, please see question 3.2 above.

As regards the domicile of the purchaser, this will not interfere with the perfection requirements as this will be a matter of the domicile of either the obligor or the seller.

**3.4 Example 3: If (a) the seller is located in Denmark but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Denmark recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Denmark's own sale requirements?**

Provided that the perfection requirements under the foreign law have been complied with, and a Danish court rules that the perfection requirements shall be subject to foreign law with reference to the domicile of the obligor outside Denmark, the sale will be effective against third parties.

Provided that the perfection requirements under the foreign law have been complied with, but a Danish court rules that the perfection requirements shall be subject to Danish law with reference to the domicile of the seller in Denmark, the sale will not be effective against third parties (if Danish requirements are more extensive).

As a precautionary measure we recommend that the seller (or the purchaser) complies with the perfection requirement in both countries in case they differ.

As regards the domicile of the purchaser, this will not interfere with the perfection requirements as this will be a matter of the domicile of either the obligor or the seller.

**3.5 Example 4: If (a) the obligor is located in Denmark but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Denmark recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Denmark's own sale requirements?**

Provided that the perfection requirements under the foreign law have been complied with, and a Danish court rules that the perfection requirements shall be subject to foreign law with reference to the domicile of the seller outside Denmark, the sale will be effective against third parties.

Provided that the perfection requirements under the foreign law have been complied with, but a Danish court rules that the perfection requirements shall be subject to Danish law with reference to the domicile of the obligor in Denmark, the sale will not be effective against third parties (if Danish requirements are more extensive).

As a precautionary measure we recommend that the seller (or the purchaser) complies with the perfection requirement in both countries in case they differ.

As regards the domicile of the purchaser, this will not interfere with the perfection requirements as this will be a matter of the domicile of either the obligor or the seller.

**3.6 Example 5: If (a) the seller is located in Denmark (irrespective of the obligor's location), (b) the receivable is governed by the law of Denmark, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Denmark recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Denmark and any third party creditor or insolvency administrator of any such obligor)?**

The sale will not be effective against third parties as a Danish court will base its decision upon the perfection requirements in either the seller's country (i.e., Denmark) or the obligor's country, and not the perfection requirement in the purchaser's country. Thus, the perfection requirements will not be satisfied (if the Danish or the foreign laws of the obligor are more extensive).

As a precautionary measure we recommend that the seller (or the purchaser) complies with the perfection requirements of the seller's and the obligor's respective countries in case they differ.

## 4 Asset Sales

**4.1 Sale Methods Generally. In Denmark what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

Generally, the seller and the purchaser will enter into a receivables purchase (or transfer) agreement governing the sale of the receivables. An assignment agreement is usually referred to in terms of a secured loan.

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

Notice to the obligor constitutes perfection in respect of sale of receivables; however, there are no specific requirements as to the form of notice and it may be served orally or in writing.

In addition hereto, we also recommend that the seller is deprived of the control over the receivable as well as over the income deriving from the receivable. Although this is not as such a perfection requirement in relation to a true sale, it is a useful precautionary measure, should the sale be re-characterised as a secured loan which would not otherwise have been duly perfected.

Once the perfection requirements are fulfilled, the sale will not only be effective against the seller's creditors but also against any subsequent good faith purchasers.

**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

In respect of a sale of promissory notes or other negotiable documents, the sale is, strictly speaking, already perfected once the parties have entered into the transfer agreement (or once the notes

etc., have been set aside for the purchaser). However, we recommend that the seller is also deprived of the control over the document either by the purchaser taking it into his own custody or by placing it in a third party's custody as a useful precautionary measure, should the sale be re-characterised as a secured loan which would not otherwise have been duly perfected.

In respect of a mortgage on real property, the sale must be registered with the Danish Land Registry in order to be perfected. This also applies in terms of chattel mortgages or car loans as the sale of such must be registered with the Danish Registry of Chattel Mortgages or the Danish Registry of Motor Vehicles, respectively.

Pursuant to the provisions of the Danish Consumer Credit Act, a consumer credit loan can only take the form of a non-negotiable document whereby the perfection requirement is notice to the obligor.

In Denmark, marketable debt securities will normally be dematerialised, i.e., they will only exist in the form of an electronic registration with the Danish securities depository – the VP Securities Services. A sale of such securities is perfected by way of registration with the VP Securities Services.

---

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

---

Yes, notice to the obligor is a perfection requirement and must be served by the seller or the purchaser.

No consent is required from the obligor (unless otherwise specifically required for in the receivable). An acknowledgment, although not required, would minimise the procedural risk of evidencing the notification having reached the obligor.

(a) No, receivables are freely assignable provided that no clause of prohibition of assignment exists.

(b) If the contract prohibits assignment, a violation of such would be a breach of contract for which the breaching party is liable, and the assignment to a purchaser or assignee should not be effective.

The general principle is that the purchaser will not obtain a more preferable legal position than that of the seller, whereby the obligor may set-off any (related) counterclaim arising out of the transferred receivable by way of netting.

Following the obligor being notified of the transfer, the obligor is no longer entitled to pay any amount under the receivables to the seller with releasing effect (provided that the notification does not state otherwise), and the obligor may only set-off any (non-related) counterclaim against the purchaser if (i) the counterclaim has been acquired prior to the obligor being notified of the transfer, and (ii) the counterclaim falls due prior to the receivable that is subject to the transfer.

The obligor and the seller may agree that the obligor's set-off rights are limited by a cut-off clause with respect to any purchaser, however, subject to the Danish Consumer Credit Act which

prohibits such cut-off clauses when the obligor is a consumer or otherwise restricted if deemed unreasonable pursuant to the Danish Contracts Act.

---

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

---

No particular requirements apply to the form of notice or to the effective service, as it may be served orally or in writing. Danish law operates on the basis of substance over form; however, the notice must be clearly defined and precise in order for the obligor to become fully aware of the transfer. The notice must reach the obligor in order for perfection to be duly obtained, and that burden of proof lies with the one serving the notice. In addition, it may be required that foreign obligors are notified in their languages.

Normally, a notice is delivered in connection with (or following) the sale, but it may be delivered earlier if the receivable(s) can be clearly specified and identified. The delivery of a notice after insolvency proceedings against the seller have commenced is ineffective against the insolvency estate of the seller and the receivable(s) would then form part thereof. The delivery of a notice after insolvency proceedings against the obligor have commenced do not hinder an effective sale against third parties, however, in practice, the insolvency estate of the obligor would be unable to pay the receivable(s) in full (i.e., the purchaser will be non-preferential creditor).

A notice may apply to a specific receivable or to any and all (including future) receivables provided that the future receivables can be clearly identified, and this requirement is deemed satisfied to a greater extent if the sale relates to all future receivables in respect of an obligor, however, Danish case law is ambiguous on the scope of one single notice and it may be deemed ineffective.

---

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?**

---

A clause restricting assignment will be interpreted in accordance with the intention of the parties and a Danish court will apply substance over form. A clause stipulating that "None of the seller's rights or obligations under this Agreement may be transferred or assigned without the consent of the obligor" will, absent any indications that the parties intended otherwise, be interpreted as restricting the transferability of the receivable. A clause restricting transferability does not need to contain a specific reference to rights or obligations.

**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Denmark? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Denmark recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

Generally, clauses prohibiting transfer or assignment are enforceable in Denmark and must be adhered to by the parties.

In terms of a breach of prohibitions on transfer or assignment to the purchaser, the seller will be liable for breach of contract, but it is generally recognised that such restrictions on transfer or assignment cannot be enforced against the seller's creditors. Furthermore, the obligor will not be bound by such sale or assignment to the purchaser and the purchaser will normally not be liable for the breach as no contract exists between the purchaser and the obligor.

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

The receivables purchase agreement has to individualise and identify the receivables sold in such detail that the purchaser is able at any time to identify which receivables have been bought. A sales agreement pursuant to which the seller sells all of its receivables (other than those owing by specifically identified obligors) is usually deemed to be sufficient identification of the receivables being sold, but it would obviously strengthen the structure if further characteristics of the receivables could be identified. No specific information requirements apply.

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

A formal sale of receivables could be re-characterised as a secured loan if the substance of the sale corresponds to that of a secured loan, as Danish law applies substance over form – thus, a Danish court would not automatically give effect to the intent of the parties.

In assessing this, one should take all aspects of the transfer into account and not just rely on a few factors. It is evident that the economic effects of such transfer are key factors in making this determination. In this respect, the Danish courts will be likely (although there is practically no case law to rely on) to re-

characterise a sale as a secured loan if the risk and benefits in relation to the receivables in general remain with the seller.

In the event of a sale of receivables in which (a) the vast majority of the credit risk and to a lesser extent the interest risk remain with the seller, and (b) where the purchaser is restricted from exercising full ownership rights over the receivables, e.g., the right to freely dispose of the receivables to a third party, is more likely to be re-characterised as a secured loan than a sale, which does not exhibit these characteristics.

In relation to (c) the control of the collections of receivables will not *per se* have a direct bearing on the re-characterisation issue, however, should the sale be re-characterised as a secured loan (i.e., the characteristics described in item (a) and (b) above apply), then the perfection requirements, in terms of depriving the seller of the control over the receivables as well as the income deriving from such, are not fulfilled. As a precautionary measure, we recommend that the seller is deprived of the control over the receivables as well as the income deriving from such, unless the collection is made under strict supervision by the purchaser.

In relation to (d) a right of repurchase/redemption does not affect the perfection, but it may, subject to the terms and conditions hereof, jeopardise the 'true sale' characterisation and be re-characterised as a secured loan (*cf.* (a) and (b) above). Particularly, an obligation of repurchase/redemption with respect to defaulted receivables is deemed to weaken the 'true sale' characterisation considerably. The terms and conditions of the repurchase/redemption should not effectively mean that the vast majority of the credit risk remains with the seller.

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

Yes, a seller can enter into an enforceable receivables transfer agreement in relation to the continuous sale of receivables. However, there may be circumstances where a continuous sale is not enforceable against third parties, *cf.* questions 4.5 and 4.10. Furthermore, it may be preferable for the purchaser to have a negative pledge registered in respect of the seller in the Danish Chattel Mortgage Registry (it requires the seller to be a company) if the seller grants a floating charge to one of its creditors which may give rise to conflicts of priority in respect of the receivables. Perfection thereof is subject to a stamp duty of approximately EUR 220.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?**

The seller can, to a certain extent, enter into a receivable transfer agreement concerning future receivables provided that the contractual relationship between the seller and the obligor, which gives rise to these future receivables, can be described in extensive detail, i.e., an agreement for the sale of future receivables from a presently undefined group of obligors will not be enforceable. Thus, the problem is the perfection requirement in terms of notifying the obligors and depriving the seller of his control, which may qualify the enforceability of the transfer.

It remains unresolved if one single notice in respect of future receivables is sufficient perfection and if such is enforceable. As a precautionary measure, we recommend that the obligors are notified of the transaction of each individual receivable from time to time.

If the transfers of the receivables, including the future receivables, are duly perfected, such receivables will not form part of the seller's insolvency estate, *cf.* question 6.5 below, and non-perfected transfers would form part of the seller's insolvency estate.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

Generally, any related security could be transferred to the purchaser together with the receivable, e.g., any insurance or guarantees for payment of the receivable. The perfection requirement would, in such instances, be notice to the relevant insurance company and guarantor, etc.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

The Danish Instrument of Debt Act contains provisions which, in some cases, entitle an obligor to exercise rights of set-off even after the receivable has been transferred. However, set-off rights in respect of non-related counterclaims may, under certain circumstances, be terminated upon notification of the obligor, please see question 4.4.

The seller or the purchaser will not be liable for damages caused by serving notice to the obligor and thereby terminating any of the obligor's set-off rights.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Denmark to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

No, in Denmark, the main risk is not whether the sale has been perfected or not, but instead whether the relevant perfection requirements have been fulfilled should the sale be re-characterised as a secured loan. Therefore, most receivables transfer agreements in Denmark are structured in such a way that all perfection requirements are met irrespectively of whether the sale is re-characterised or not.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Denmark, and for such security interest to be perfected?**

In order to create a security interest over the receivables and any

related security, the parties would have to enter into a pledge agreement in relation to these assets. The perfection requirement would be notice to the obligors along the same lines as in relation to true sale. In addition, the seller must be deprived of the control over the receivables as well as over any income deriving from these receivables.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Denmark to grant and perfect a security interest in purchased receivables governed by the laws of Denmark and the related security?**

As regards security interest over the purchased receivables and any related security, the purchaser must comply with the requirements set out in question 5.2.

Pursuant to the Danish Registration Act, no person may grant security interests over all of his present or future assets, whereby the purchaser is unable to grant security interests over all of its assets. As an exemption, the purchaser may grant a floating charge over some of its assets (including receivables, intellectual property, etc.) by way of registering an all-monies mortgage in the Danish Registry of Chattel Mortgages. Perfection is subject to a stamp duty of approximately EUR 220 and an additional 1.50 per cent of the nominal amount of the all-monies mortgage.

In the event that the purchaser is to grant security over any specific assets, the perfection requirements may differ as different acts of perfection apply to the various types of assets.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Denmark, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Denmark or must additional steps be taken in Denmark?**

Subject to the qualifications set out in question 2.3, the security interest granted will be considered valid between the purchaser and the relevant third party.

According to Danish international private law, any issue regarding third party rights must be addressed with reference to the law of the country where the receivable is deemed to be located – referred to as the *lex rei sitae* rule. As stated in the answer to question 3.2, a receivable may be deemed to be situated either at the obligor's or the purchaser's (as it is now the creditor in respect of the receivables) domicile.

The effectiveness of the security interest may be affected in the event that a Danish court bases its decision upon the perfection requirement in the obligor's country (provided that the domicile of the obligor is, in fact, Denmark), if only the perfection requirements in the purchaser's country has been complied with. As a precautionary measure we recommend that the purchaser (or the person for whom the security interest is granted in favour of) complies with the perfection requirement in both countries in case they differ.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

In order to create a valid and perfected security interest over a promissory note or any other negotiable document, the parties have to enter into a pledge agreement. In addition hereto, the pledgee

will also have to deprive the pledgor of the control over the relevant document, either by taking it into his own custody or by transferring it to a third party. In relation to marketable debt securities, the perfection requirement is registration of the security interest in the VP Securities Centre.

**5.6 Trusts. Does Denmark recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

A trust cannot be established under Danish law and the concept of trust is not generally recognised under Danish law, however, the existence of a validly created trust under foreign law may be recognised in Denmark as a matter of Danish conflict of law rules.

The concept of agency is recognised under Danish law, whereby a single legal entity may be appointed to act as agent on behalf of others and hold the receivables, collect the payments made or enforce any security granted. An agency contract (e.g., power of attorney) should define the agent's authority. Please also see new regulation on trustees and security agents in question 7.1.

**5.7 Bank Accounts. Does Denmark recognise escrow accounts? Can security be taken over a bank account located in Denmark? If so, what is the typical method? Would courts in Denmark recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Denmark?**

Yes, Denmark recognises escrow accounts.

Yes, security may be taken over a bank account located in Denmark and is perfected by way of notification to the account bank and depriving the pledgor control of the bank account. Thus, the pledged bank account must be blocked and the pledgor's access must be made subject to discretionary consent of the pledgee.

No, the Danish courts will not recognise a foreign-law grant of security over an asset located in Denmark as any issue regarding third party rights must be addressed in accordance with the *lex rei sitae* rule, which, in this event, will refer to Danish law provided that the perfection requirement of a bank account pledge in the foreign country is not similar to those in Denmark.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

Yes, security may be created over bank accounts and the balance from time to time standing to the credit of the pledgor, including interest. Upon enforcement of the security, the secured party will control all cash flowing into the pledged account until being repaid in full. Provided that no amount transferred to the account is earmarked, e.g., insurance proceeds, or subject to limitations in the bank accounts pledge agreement, no material limitations apply.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Yes, security may be created over bank accounts; however, it is a

perfection requirement that the pledgor is deprived of the control of the bank accounts, including the balance standing to the credit of it. If the pledgor is not deprived of the control, the pledge will not be effective against third parties. This requirement may be inconvenient for the pledgor, and it may be solved by permitting the pledgor to operate a parallel (non-pledged) bank account into which amounts from the pledged bank accounts may be transferred with the consent of the secured party.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Danish insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

If a true sale of the receivables is upheld and has been duly perfected and is not subject to any reversibility, the receivables will not form part thereof and the purchaser may continue to exercise any ownership rights without any involvement of the seller's insolvency estate.

If a security interest over the receivables has been duly perfected and is not subject to any reversibility, the purchaser is a secured preferential creditor with preference to enforce the security interest directly without any involvement of the seller's insolvency estate.

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

Under the precondition that (i) the sale is upheld as a true sale and not subject to any reversibility, or (ii) the security interest is duly perfected and not subject to any reversibility, the insolvency official will have no such powers.

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Denmark for (a) transactions between unrelated parties, and (b) transactions between related parties?**

Generally, an otherwise duly perfected transaction could be reversed if the transfer is preferential towards one creditor or if it diminishes the pool of assets which would otherwise form part of the insolvency estate. The reversibility may relate to (i) gifts, (ii) payments, and (iii) security interest.

(i) Any gift to the purchaser may be voided by the insolvency official if such is made six months prior to the adjudication of insolvency. In case a gift is received by a party related to the obligor, the preference period is, under certain circumstances, extended to two years.



(ii) Any payment made to the purchaser may be voided by the insolvency official if such is made three months prior to the adjudication of insolvency provided that the payment is made (a) by abnormal means, (b) prior to the debt being due, or (c) with the effect of decisively deteriorating the obligor's ability to pay. If payment is made to a party related to the obligor, the preference period is, under certain circumstances, extended to two years.

(iii) Any security granted to the purchaser for the security of existing debt may be voided by the insolvency official if such is issued three months prior to the adjudication of insolvency. In case a security is granted to a party related to the obligor, the preference period is, under certain circumstances, extended to two years.

Furthermore, a general clause exists in which the insolvency official may reverse transactions in a period which is – in principle – unlimited.

---

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

---

In general, Danish corporate law distinguishes between the purchaser, the seller and its affiliates each as being separate legal entities, whose rights and liabilities must be addressed separately.

The Danish courts in some cases deviated from this in case the economy and management of entities have been interconnected to such an extent that the boundaries of the legal entities become blurred, or if the entities have tried to take advantage of the corporate structure and its limited liability in order to favour certain creditors.

---

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Denmark, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

---

Upon the adjudication of insolvency, the insolvency official will be put in charge of the seller's assets which form part of the insolvency estate, including any receivable transfer agreement entered into by the seller (e.g., the right to receive payment thereunder). If such agreement concerns the sale of future receivables and is valid, *cf.* question 4.10, and does not constitute a preference, the insolvency official can choose to either terminate the contract or to honour it. In respect of the latter option, the agreement will have a preceding position in the insolvency proceedings but the number of future receivables will decline as the insolvency official is winding-up the business of the seller, which gives rise to the receivables.

---

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

---

A debtor can be declared bankrupt if it cannot pay its debts as they become due, unless its inability to pay is presumed to be only temporary. A limited recourse provision in the debtor's contracts does not prevent its creditors from commencing bankruptcy proceedings on the grounds that the debtor cannot pay its debts to (non-limited recourse) creditors as they become due.

---

## 7 Special Rules

---

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Denmark establishing a legal framework for securitisation transactions? If so, what are the basics?**

---

As of 1 October 2011, a special securitisation scheme is available for financial institutions in Denmark under the Danish Securities Act, pursuant to which the Danish National Bank may provide funding to a financial institution against obtaining security interests in certain assets of that financial institution (e.g., loans, overdraft facilities, and securities – not including accounts receivables) subject to a haircut. Perfection is made by way of the financial institution forwarding a list of the secured assets to the Danish National Bank, and thereby dispensing from the requirement of notification.

As of January 2014 and for the purpose of increasing businesses' access to better financing, securitisation regulation has been implemented in the Danish Financial Business Act, which enables banks to securitise rights under, *inter alia*, loans, credits and leases (that are made available to businesses) by way of establishing a refinancing register, however, subject to any restrictions on transferability in the agreements. By registering the sale in the refinancing register, banks will be able to sell rights under said loans, credits and leases to an authorised entity (e.g., a special purpose vehicle, a bank or a pension fund). Registration constitutes perfection of the sale, which entails that notice to the obligors is not required and the banks will remain in charge of administering the loans, credits and leases. Upon registration, the authorised entity will be protected against the banks' creditors; however, the authorised entity will not be protected against any subsequent good faith purchases (as there is no duty to inspect the refinancing register for such purchases). Obligors will still be able to make payments with releasing effect to the banks (to the extent they are not notified otherwise) and the obligors' right of set-off toward the banks is not affected. Banks may only establish a refinancing register upon permission from the Danish Financial Supervisory Authority.

Furthermore and as of January 2014, Denmark has implemented regulation on trustees and security agents in the Danish Securities Trading Act, which resolves the uncertainty of recognising the use of trustees and security agents in syndicated loans and bond issuances. Such regulation is expected to pave the way for a more lenient and less onerous approach when establishing securitisation structures, particular with respect to security, subsequent transfers and legal proceedings.

---

**7.2 Securitisation Entities. Does Denmark have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

---

No, Denmark has not adopted any special legislation in respect of such special purpose entities, except for new regulation on establishing refinancing registers, *cf.* question 7.1 or if within the scope of regulation on Alternative Investment Fund Managers, *cf.* question 8.1. However, any entities which (i) purchase any receivables or other assets from an originator, and (ii) fund their acquisitions by issuing bonds to the general public in Denmark might become subject to the provisions of the Danish Financial Business Act.

**7.3 Limited-Recourse Clause.** Will a court in Denmark give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

Yes, in general the Danish courts will give effect to such a contractual provision, unless the courts deem it to be unreasonable, and if the agreement is governed by foreign law, provided that the choice of foreign law is a valid choice of law made in accordance with the EC Convention on the Law Applicable to Contractual Obligations (Rome 1980) and subject to the qualifications set out in question 2.3.

**7.4 Non-Petition Clause.** Will a court in Denmark give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Yes, in general the Danish courts will give effect to such a contractual provision, unless the courts deem it to be unreasonable, and if the agreement is governed by foreign law, provided that the choice of foreign law is a valid choice of law made in accordance with the EC Convention on Law Applicable to Contractual Obligations (Rome 1980) and subject to the qualifications set out in question 2.3.

**7.5 Priority of Payments "Waterfall".** Will a court in Denmark give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

A Danish court will give effect to a "waterfall" provision, unless the courts deem it to be unreasonable, and if the agreement is governed by foreign law, provided that the choice of foreign law is a valid choice of law made in accordance with the EC Convention on Law Applicable to Contractual Obligations (Rome 1980) and subject to the qualifications set out in question 2.3.

**7.6 Independent Director.** Will a court in Denmark give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

No, as the directors of a Danish company are under a statutory duty to safeguard the interests of the shareholders, as well as the interests of the company's creditors, this duty cannot be limited by way of agreement or otherwise and any attempt to act in accordance with such an agreement could subject the directors of the company to liability towards the shareholders and/or the creditors of the company.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc.** Assuming that the purchaser does no other business in Denmark, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Denmark? Does the answer to the preceding question change if the purchaser does business with other sellers in Denmark?

Generally, purchase, ownership or enforcement of Danish receivables, as well as the collection of these receivables, will *per se* qualify as doing business in Denmark and will not require any licences or authorisations under the Danish Financial Business Act.

With the introduction in Danish law of the Directive 2011/61/EU on Alternative Investment Fund Managers, the purchaser may become subject to such regulation provided that it does not fall within the scope of the exemption provisions.

**8.2 Servicing.** Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

If the seller enforces and collects the receivables following the transfer to the purchaser, the seller will require a licence pursuant to the Danish Debt Collection Act, which will also be required in case of any third party replacement servicer, however, not applicable to attorneys at law. A licence will not be required if the seller enforces and collects the receivables prior to the transfer to the purchaser.

**8.3 Data Protection.** Does Denmark have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

The Danish Data Protection Act applies to the processing and dissemination of personal data relating to private individuals whether being consumers or not and to some extent to corporate entities (primarily in relation to the processing of credit information by credit agencies).

According to the provisions of the act, personal data may only be gathered for specifically stated purposes and must be processed in accordance with good data processing practice.

In addition hereto, the processing of data as well as the dissemination of data will often require the consent of the relevant person, especially in cases where the data is transferred to third countries outside of the European Economic Area, which do not have an adequate level of data protection.

**8.4 Consumer Protection.** If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Denmark? Briefly, what is required?

Consumers are protected by the Danish Consumer Contract Act, and depending on the nature of a securitisation, the receivables may often be subject to the provisions of the Danish Consumer Contract Act, which applies generally to consumer credit agreements. The

Act contains various provisions in respect of interest rate fixing, calculation of costs and prepayment options, as well as a number of information requirements, which the purchaser will have to comply with, *cf.* question 1.2 above.

---

**8.5 Currency Restrictions. Does Denmark have laws restricting the exchange of Danish currency for other currencies or the making of payments in Danish currency to persons outside the country?**

---

Apart from payments to persons in countries under embargos or sanctions imposed by the United Nations and/or the European Union, there are no restrictions to the exchange of the Danish currency (DKK).

---

## 9 Taxation

---

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Denmark? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

---

There is no withholding or other tax to be deducted by the obligor from any payment, whether of principal, interest or other amounts (discount or premium) to be made pursuant to the receivable, except in certain cases on payments between related parties (companies controlled by voting power by the same ultimate parent company).

---

**9.2 Seller Tax Accounting. Does Denmark require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

---

No specific accounting policy is required in the context of securitisation. Good accounting practice is a legal standard in Denmark which all accountants must follow.

---

**9.3 Stamp Duty, etc. Does Denmark impose stamp duty or other documentary taxes on sales of receivables?**

---

No, there is no stamp duty or documentary taxes on the sale of receivables. As stated in question 5.3 above, a security interest over the receivables created as a floating charge will be subject to a stamp duty.

---

**9.4 Value Added Taxes. Does Denmark impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

---

Value Added Tax (VAT) of 25 per cent is as a starting point due on any sold goods or services made in Denmark, where it is a taxable supply made by a taxable person in the course or furtherance of a business carried on by said person.

Sales of receivables are VAT exempt in Denmark.

Collection agent services are subject to VAT in Denmark.

VAT on the sold goods or services made in Denmark may only be deducted by the seller of the goods or services if a loss is accrued on the receivable. A purchaser of a receivable is not allowed to deduct VAT if a loss is accrued on the obligor, as the purchaser is not subject to any gain realised on the receivable, *cf.* question 9.5 below.

---

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

---

The seller alone is responsible for the payment of VAT and excise duties. No claims for indirect taxes can be made against the purchaser of the liabilities.

---

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Denmark, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Denmark?**

---

Under the precondition that the purchaser does not have any permanent establishment in Denmark, the mere ownership and collection of the receivables will not make the purchaser liable to Danish taxation.

**Kim Toftgaard**

Accura Advokatpartnerselskab  
Tuborg Boulevard 1  
DK-2900 Hellerup  
Denmark

Tel: +45 3945 2802  
Fax: +45 3945 2801  
Email: [kim.toftgaard@accura.dk](mailto:kim.toftgaard@accura.dk)  
URL: [www.accura.dk](http://www.accura.dk)

Languages: Scandinavian languages and English.  
Kim Toftgaard graduated in Law from the University of Copenhagen in 1994, and, in 1999, he obtained an LL.M. with distinction from Georgetown University, Washington, D.C. Furthermore, he holds an HD (Business Finance) from the Copenhagen Business School. He was admitted to the Danish Bar in 1997 and to practise law before the Danish High Courts in 1998.

Kim Toftgaard is a partner in Accura's banking and finance group. He specialises in acquisition finance and structured finance and has advised major Danish and foreign banks, listed corporate entities and private equity funds on the financing and structuring of bond issues and securitisation of various assets such as mortgages, securities, loans, receivables and leasing activities in Denmark and on a cross-border basis. Kim Toftgaard has been recognised in a number of international survey-based directories within banking and structured finance.

**Christian Sahlertz**

Accura Advokatpartnerselskab  
Tuborg Boulevard 1  
DK-2900 Hellerup  
Denmark

Tel: +45 3945 2840  
Fax: +45 3945 2801  
Email: [christian.sahlertz@accura.dk](mailto:christian.sahlertz@accura.dk)  
URL: [www.accura.dk](http://www.accura.dk)

Languages: Scandinavian languages and English.  
Christian Sahlertz graduated in Business Administration and Commercial Law from the Copenhagen Business School in 2010, and in 2013 he graduated in Law from the University of Aarhus. Christian Sahlertz is an associate in Accura's banking and finance group, and specialises in structured finance, acquisition finance and investment funds and has advised major Danish and foreign banks and investment funds on their activities in Denmark and on a cross-border basis.

# ACCURA

*forward reflection*

Accura is one of the leading Danish law firms within M&A, real estate, banking and financing, competition, employment and insolvency.

Accura's banking and finance group represents some of the most active foreign and domestic players in the Danish market for banking and financial services. Our practice is focused on acquisition finance, property finance, structured finance, securities, financial institutions and investment funds.

Accura's banking and finance group provides regular advisory services to market-leading European companies in respect of the legal problems relating to securitisation under Danish law, and offer expertise in connection with the securitisation of mortgages, securities, receivables, credit cards, leasing activities, etc.

# England & Wales



Rupert Wall



Jacky Kelly

Weil, Gotshal &amp; Manges

## 1 Receivables Contracts

- 1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

With the exception of certain debts arising under regulated consumer credit arrangements, a debt need not be in writing to be enforceable against the obligor but must arise as a matter of contract or deed. Contracts may be written, oral or partly written and partly oral. An invoice (depending on its terms) may itself represent the contract between the parties or evidence a debt arising pursuant to such a contract. Where a contract is oral, evidence of the parties' conduct is admissible for the purposes of ascertaining the terms of the contract. A contract may be implied between parties based on a course of conduct or dealings where the obligations arising from the alleged implied contract are sufficiently certain to be contractually enforceable.

- 1.2 Consumer Protections. Do the laws of England & Wales: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

- a) Consumer credit loans are regulated by the Consumer Credit Act 1974, as amended by the Consumer Credit Act 2006 and the implementation of the Consumer Credit Directive in 2010 (together the CCA). There is no maximum interest rate set out by this legislation. However, the Banking Reform Act 2012 has introduced a requirement that the UK Financial Conduct Authority (the FCA) make rules which impose a cap on the interest rate charged by high-cost short-term lenders (i.e. loans which are for a term of 12 months or less, and for which the annualised percentage rate of interest is 100 per cent. or more). The FCA has yet to make these rules.
- b) There is a statutory right to interest on late payments but this does not apply to consumer credit agreements.
- c) Borrowers pursuant to regulated consumer credit agreements (under the CCA) may cancel the credit agreement up to 14 days from execution.
- d) Certain clauses of receivables contracts may be found to be unfair under the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR) and consequently may be

unenforceable against the consumer. The Consumer Protection from Unfair Trading Regulations prohibit certain practices that are deemed unfair.

From 1 April 2014, the FCA will take over responsibility for consumer credit regulation in the UK from the OFT. The FCA's new consumer credit sourcebook (known as CONC) contains a number of important protections for consumers (e.g. in relation to arrears, default and recovery), with which authorised persons must comply.

Under the Financial Services Act 2012: (a) carrying on certain credit-related regulated activities (including in relation to servicing) otherwise than in accordance with permission from the FCA will render the credit agreement unenforceable (subject to the possibility of an FCA Validation Order, in certain limited circumstances); and (b) the FCA will have power to render unenforceable contracts made in contravention of its rules on cost and duration of credit agreements or in contravention of its product intervention rules.

- 1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

Not specifically, although there may be enforcement issues as a result of the laws pertaining to sovereign immunity.

## 2 Choice of Law - Receivables Contracts

- 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in England & Wales that will determine the governing law of the contract?**

For contracts entered into between 1 April 1991 and 16 December 2009, the relevant law is the Contracts (Applicable Law) Act 1990, which enacted the Rome Convention on the law applicable to contractual obligations (80/934/EEC) (**Rome Convention**) in England & Wales. For contracts entered into on, or after, 17 December 2009, the position is governed by Regulation 593/2008/EC of 17 June 2008 (**Rome I**).

The Rome Convention states that, absent an express choice of law, the applicable law of a contract will be that of the country with which it has the closest connection. There is a presumption that this will be the country where the party who is to effect the performance of the contract has his habitual residence (if an individual) or its central administration (if a corporate entity). However, if the

contract is entered into in the course of that party's trade or profession, the country with the closest connection is the country in which the party's principal place of business is situated. Where, under the terms of the contract, the performance is to be effected through a place of business other than the principal place of business, it is the country in which that other place of business is situated. These presumptions will not apply if it is clear from the circumstances as a whole that the contract is more closely connected with another country. It should also be noted that certain classes of contracts fall outside the scope of the Rome Convention.

Under Rome I, the position is largely the same, save that the presumption in favour of the law of the place where the party effecting performance has his habitual residence is a fixed rule. This fixed rule may be displaced if the contract falls into one of several defined classes (for which specific rules apply) or if the contract is manifestly more closely connected with the law of a different country (in which case the law of that country is the applicable law) or if it is sufficiently certain from the terms or circumstances of the contract which law the parties chose to apply (in which case that law will be the applicable law).

For those types of contract which fall outside the scope of the Rome Convention or Rome I, the applicable law will be decided by reference to English common law principles. Those principles seek first to determine which law the parties intended to govern the contract. If no such intention can be established, the applicable law of the contract is that with which the contract has its closest and most real connection in light of all the material circumstances. In deciding this, the English courts will consider which law the ordinary businessman would have intended to apply.

**2.2 Base Case. If the seller and the obligor are both resident in England & Wales, and the transactions giving rise to the receivables and the payment of the receivables take place in England & Wales, and the seller and the obligor choose the law of England & Wales to govern the receivables contract, is there any reason why a court in England & Wales would not give effect to their choice of law?**

No, there is not.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in England & Wales but the obligor is not, or if the obligor is resident in England & Wales but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in England & Wales give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

Both the Rome Convention and Rome I stress the importance of the parties' freedom to choose the law of their contract (including a foreign law). This choice can be express or implied. The Rome Convention and Rome I allow for modification of the parties' choice only: (i) where all elements of a contract are connected to a country other than the country whose law has been chosen by the parties and that country has rules which cannot be disapplied by contract (in which case the court will apply those rules); (ii) to the extent that the law chosen conflicts with overriding mandatory rules of English law (as the law of the forum); or (iii) where the applicable foreign law is manifestly incompatible with English public policy. Additionally, under Rome I, the English courts will modify the parties' choice of law where the overriding mandatory

rules of the place of performance render performance of the contract unlawful.

For those types of contracts not within the scope of the Rome Convention or Rome I, the common law is also highly supportive of the parties' choice of a foreign law and will only modify such a choice in exceptional circumstances.

**2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in England & Wales?**

No, it is not.

### 3 Choice of Law - Receivables Purchase Agreement

**3.1 Base Case. Does the law of England & Wales generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., the laws of England & Wales or foreign laws)?**

As discussed above, under the Rome Convention or Rome I (subject to the limited exceptions described in question 2.3) the parties to a contract are free to agree that the contract be governed by the law of any country, irrespective of the law governing the receivables. The law governing the sale agreement together with mandatory rules of the jurisdiction of the seller will govern the effectiveness of the sale between the seller and the purchaser, whilst the governing law of the receivables will govern perfection of that sale and the relationship between the purchaser and the underlying obligor.

**3.2 Example 1. If: (a) the seller and the obligor are located in England & Wales; (b) the receivable is governed by the law of England & Wales; (c) the seller sells the receivable to a purchaser located in a third country; (d) the seller and the purchaser choose the law of England & Wales to govern the receivables purchase agreement; and (e) the sale complies with the requirements of England & Wales, will a court in England & Wales recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?**

Yes, it will.

**3.3 Example 2. Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside England & Wales, will a court in England & Wales recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?**

See questions 3.1 and 3.2 above. In addition, under the Rome Convention and Rome I, there are limited circumstances where certain legal provisions of countries other than the country whose law was selected to govern the receivables purchase agreement may (but need not) be taken into account, such as where performance of the contract (by virtue of the location of the purchaser, the obligor, both or neither) is due in a place other than England & Wales, in which case the English courts have discretion whether to apply certain mandatory provisions of the law of the country where performance of the contract is due, in

so far as non-application of those overriding provisions would render the performance of the contract unlawful in that country.

- 3.4 Example 3. If: (a) the seller is located in England & Wales but the obligor is located in another country; (b) the receivable is governed by the law of the obligor's country; (c) the seller sells the receivable to a purchaser located in a third country; (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement; and (e) the sale complies with the requirements of the obligor's country, will a court in England & Wales recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with the sale requirements of the law of England & Wales?**

Under the Rome Convention and Rome I, the validity of a contract will be determined by reference to the governing law of that contract as chosen by the parties. In assessing the validity of the receivables purchase agreement, the English courts would apply the law of the receivables purchase agreement (in this case, the law of the obligor's country) and as to the perfection of the sale, the governing law of the receivables (in this case, also the law of the obligor's country). However, as discussed in question 2.3 above, certain mandatory principles of the law of England & Wales (such as mandatory principles of insolvency law in the seller's insolvency) would not be capable of disapplication by the parties' choice of a foreign law. Further, the courts would not apply the parties' choice of a foreign law to the extent it conflicted with those mandatory principles, or was manifestly incompatible with public policy.

- 3.5 Example 4. If: (a) the obligor is located in England & Wales but the seller is located in another country; (b) the receivable is governed by the law of the seller's country; (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement; and (d) the sale complies with the requirements of the seller's country, will a court in England & Wales recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with the sale requirements of the law of England & Wales?**

See questions 3.1 and 3.4 above. The English courts would recognise the sale as effective against the obligor as it complies with the requirements of the law governing the receivable (in this case the law of the seller's country).

- 3.6 Example 5. If: (a) the seller is located in England & Wales (irrespective of the obligor's location); (b) the receivable is governed by the law of England & Wales; (c) the seller sells the receivable to a purchaser located in a third country; (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement; and (e) the sale complies with the requirements of the purchaser's country, will a court in England & Wales recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in England & Wales and any third party creditor or insolvency administrator of any such obligor)?**

See questions 3.1 to 3.5 above. The sale would be effective against the seller provided it complied with the perfection requirements of the governing law of the receivables (in this case English law). In addition, certain principles of English law may apply to govern the

relationship between the purchaser and the obligor and in any insolvency proceedings of the seller and/or obligor in England & Wales.

## 4 Asset Sales

- 4.1 Sale Methods Generally. In England & Wales what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

The most common method of selling receivables is by way of assignment (either equitable or legal). Alternatives to assignment include a trust over the receivables (coupled with a power of attorney), a trust over the proceeds of the receivables, sub-participation (essentially a limited recourse loan to the seller in return for the economic interest in the receivables) and novation (a transfer of both the rights and obligations under the contract). An outright sale of receivables may be described as a "sale" or "true sale", a "transfer" or an "assignment", although "assignment" most often indicates a transfer of rights but not obligations (because, as a technical legal matter, it is not possible to "assign" obligations), whilst "transfer" often indicates a transfer of rights and obligations by novation. The phrase "security assignment" is often used to distinguish a transfer by way of security from an outright assignment.

- 4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

To perfect an assignment of receivables express notice in writing is required to be given to the obligor. The giving of such notice will not, in itself, result in the assignment becoming a legal, rather than equitable, assignment as certain other formalities are also required under s.136 of the Law of Property Act 1925 (LPA); namely the assignment has to be: (i) in writing and signed by the assignor; (ii) of the whole of the debt; and (iii) absolute and unconditional and not by way of charge. Where the sale of a receivable falls short of these requirements it will take effect as an equitable assignment and any subsequent assignment effected by the seller and notified to the obligor prior to the date on which the original assignment is notified to the obligor, will take priority. A novation of receivables (pursuant to which both rights and obligations are transferred) requires the written consent of the obligor as well as the transferor and transferee.

- 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

The transfer requirements for promissory notes (as well as other negotiable instruments) are governed by the Bills of Exchange Act 1882, which provides that they are transferable by delivery (or delivery and endorsement).

Mortgage loans and their related mortgages may be transferred by assignment. With respect to a mortgage over real property, as well as the giving of notice, certain other formalities need to be complied with in order to effect a legal assignment, for example registration of the transfer at H.M. Land Registry as required by the Land Registration Act 2002. Most residential mortgage securitisations are structured as an equitable assignment of mortgage loans and their related

mortgages to avoid the burdensome task of giving notice to the mortgagors and registering the transfer. However, until notice is given and the formalities satisfied, the rights of an assignee of a mortgage may be adversely affected by dealings in the underlying property or the mortgage, as described in question 4.4 below.

See questions 8.1 to 8.4 below in relation to specific regulatory requirements in relation to consumer loans.

Transfers of marketable securities in bearer form will be achieved by delivery or endorsement and, if in registered form, by registration of the transferee in the relevant register. Dematerialised marketable securities held in a clearing system represented by book-entries may be transferred by debiting the clearing system account of the relevant seller and crediting the clearing system account of the purchaser (or, in each case, its custodian or intermediary).

Specific statutory requirements may also apply for assignments of receivables such as intellectual property rights and certain policies of insurance.

---

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

---

Assuming the receivable does not fall into a select category of contractual rights which are incapable of assignment either as a matter of public policy or because the rights are of a personal nature, in the absence of an express contractual prohibition on assignment, receivables may be assigned without notification to, or consent of, the obligor. To the extent that a receivable is the subject of a contractual prohibition on assignment, other methods of transfer may be available (see question 4.1 above and questions 4.6 to 4.7 below) depending on the exact wording of the contract.

The absence of notice has the following implications: (i) obligors may continue to discharge their debts by making payments to the seller (being the lender of record); (ii) obligors may set-off claims against the seller arising prior to receipt by the obligors of the notice of assignment; (iii) a subsequent assignee of (or fixed chargeholder over) a receivable without notice of the prior assignment by the seller would take priority over the claims of the initial purchaser; (iv) the seller may amend the agreement governing the terms of the receivable without the purchaser's consent; and (v) the purchaser cannot sue the obligor in its own name (although this is rarely an impediment in practice).

---

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

---

Notice must be in writing and given by the seller or the purchaser

to the obligor and may not be conditional, although there is no particular form of notice that is required. The notice need not give the date of the assignment, but a specified date must be accurate. The main requirement is that the notice is clear that the obligor should pay the assignee going forward.

There is no specific time limit for the giving of notices set down in the LPA and notice can be given to obligors post-insolvency of the seller (including pursuant to an irrevocable power of attorney granted by the seller) or of the obligor. The giving of such notice should not be prohibited by English insolvency law although failure to give notice will have the effects set out in question 4.4 above.

---

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?**

---

See questions 4.1 and 4.4 above. Whilst the appropriate classification will ultimately be a question of construction, absent the obligor's consent, the first restriction would likely be interpreted as prohibiting a transfer of receivables by the seller to the purchaser. In the second instance the result would likely be the same provided that, at the time the receivables contract was entered into, the intention of the seller and the obligor was to restrict both the transfer of the performance of the receivables contract (e.g. the right to require performance of the receivables contract) as well as the transfer of any rights and/or obligations under that contract (e.g. accrued rights of action or rights to receive any payments). As set out in question 4.1 above, under the common law the burden of a contract cannot be assigned, only transferred with the consent of the obligor (which constitutes a novation). Where a contract therefore refers to the "assignment of an agreement" an English court would likely find that this referred to either a novation of the rights and obligations (which is not strictly speaking a transfer, it is the replacement of the old contract with an identical new contract between the new party and continuing party) or the assignment of rights coupled with the sub-contracting of obligations from purported assignor to purported assignee, although this would ultimately be a question of construction.

---

**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in England & Wales? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If England & Wales recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

---

See questions 4.1, 4.4 and 4.6 above. Restrictions on assignments or transfers of receivables are generally enforceable. If a contract is silent on assignability, then such contract and the receivables arising thereunder will be freely assignable. In very limited circumstances, such as upon the death of an individual or in certain limited statutory transfers, assignment may take place by operation of law, overriding an express contractual provision prohibiting



assignment. It may be possible to utilise a trust arrangement where non-assignment provisions within contracts would otherwise prevent assignment.

If an assignment is effected in breach of a contractual prohibition on assignment, although ineffective as between the obligor and the seller (to whom the obligor can still look for performance of the contract), such assignment may still be effective as between the seller and purchaser if in compliance with the governing law and explicit terms of the receivables purchase agreement. If the seller can establish that the obligor has accepted the assignment either through its conduct or by waiver (for example by course of dealing) then the obligor may be estopped from denying the assignment, even where there is a contractual prohibition on assignment.

---

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

---

The sale document must describe the receivables (or provide for details of the receivables to be provided at the point of sale) with sufficient specificity that the receivables can be identified and distinguished from the rest of the seller's estate. For confidentiality reasons, it is atypical for obligors' names to be included in the information provided to the seller.

---

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

---

A transaction expressed to be a sale will be recharacterised as a secured financing if it is found to be a "sham", i.e. if the documents do not reflect the actual agreement between the parties. Further, irrespective of the label given to a transaction by the parties, the court will look at its substance and examine whether it creates rights and obligations consistent with a sale.

Case law has established a number of key questions to be considered when concluding that a transaction is a true sale rather than a secured financing:

- 1) Do the transaction documents accurately reflect the intention of the parties and are the terms of the transaction documents consistent with a sale as opposed to a secured financing?
- 2) Does the seller have the right to repurchase the receivables sold?
- 3) Does the purchaser have to account for any profit made on any disposition by it of the receivables?
- 4) Is the seller required to compensate the purchaser if it ultimately realises the acquired receivables for an amount less than the amount paid?

However, a transaction may still be upheld as a sale notwithstanding the presence of one or more of these factors. As a

result, the intention of the parties, their conduct after the original contract and the express terms of the contract will all be factors when a court decides, as a whole, whether or not a contract is inconsistent with that of a sale.

The seller remaining the servicer/collection agent of the receivables post-sale, the seller entering into arm's length interest-rate hedging with the purchaser, the seller assuming some degree of credit risk by assuming a first loss position and the right of a seller to repurchase receivables in limited circumstances are not generally considered to be inherently inconsistent with sale treatment. The seller retaining an equity of redemption in respect of a transfer of receivables may, however, lead a court to the conclusion that the transaction is a security arrangement, not an outright transfer.

If the sale is recharacterised as a secured financing, the assets "sold" will remain on the seller's balance sheet and the loan will be shown as a liability of the seller. In addition, given the practice in England & Wales not to make "back-up" security filings, the security may not have been registered and may, therefore, be void in an insolvency of the seller for lack of registration (subject to the application of the FCR as referred to in question 5.3 below).

In addition to recharacterisation, sale transactions are also vulnerable under certain sections of the Insolvency Act 1986 such as those relating to transactions at an undervalue and preferences.

---

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

---

An agreement pursuant to which a seller agrees to sell receivables on a continuous basis prior to the occurrence of certain specified events will take effect, as between the seller and purchaser, as an agreement to assign. The receivables will be automatically assigned to the purchaser as, and when, they come into existence. See the answer to question 6.5 below on the effect of an insolvency of the seller on an agreement to assign a receivable not yet in existence.

---

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?**

---

An assignment for value of an identifiable receivable, which is not in existence at the time of the receivables purchase agreement, but which will be clearly ascertainable in the future, is treated as an agreement to assign which will give rise to an equitable assignment of the receivable as soon as it comes into existence. See the answer to question 6.5 below on the effect of an insolvency of the seller on an agreement to assign a receivable not yet in existence.

---

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

---

Security for a receivable will typically be capable of being assigned in the same manner as the receivable itself. The transfer or

assignment of some types of security may require additional formalities such as registration or payment of a fee as referred to in question 4.3 above.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

Generally speaking, an obligor's right to set-off (i) amounts owing to it from the seller, against (ii) amounts it owes to the seller, under that receivables contract will survive receipt of notice of a sale against the assignee of the receivables contract provided that the obligor's cross-debt arose before the obligor received notice of the sale. The assignee takes the benefit of the receivables contract subject to whatever rights of set-off existed between the obligor and the seller at the time the obligor receives notice of the sale.

If the cross-debt arises after the obligor has received notice of the sale, the obligor will generally be unable to set-off such cross-debt against the purchaser unless the claims of the obligor and the purchaser are sufficiently closely connected.

An obligor's right to set-off under a receivables contract can also terminate if the cross-debt becomes unenforceable or time-barred. In the absence of a breach of any contrary provision, it is unlikely that either the seller or the purchaser would be liable to the obligor for damages as a result of any of the obligor's rights of set-off terminating by operation of law.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in England & Wales to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

It is not customary to create "back-up" security over a seller's ownership interest in receivables and related security when an outright sale is intended although a seller may create a trust over the receivables in favour of the purchaser to the extent that any outright sale is either held to be void or is subsequently recharacterised.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of England & Wales, and for such security interest to be perfected?**

See questions 5.1 above and 5.3 below.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in England & Wales to grant and perfect a security interest in purchased receivables governed by the laws of England & Wales and the related security?**

Although security may be taken over receivables by way of

novation, attornment, pledge (in the case of documentary receivables capable of being delivered) or by retention of title arrangements, security is most commonly taken over receivables by way of mortgage or charge.

Receivables assigned by way of security together with a condition for re-assignment on redemption or discharge of the secured obligation will create a mortgage over the receivables which will either be legal (if the procedural requirements of the LPA identified in question 4.2 above are satisfied) or, in the absence of these requirements (or where the subject property is not currently owned or in existence), equitable. Prior to the perfection of an equitable mortgage, the assignee's security will be subject to prior equities (such as rights of set-off and other defences), will be liable to take priority behind a later assignment where the later assignee has no notice of the earlier assignment and himself gives notice to the obligor, and the obligor will be capable of making good discharge of its debt by paying the assignor directly (see questions 4.4 and 4.5 above).

Alternatively, the receivables may be made the subject of a fixed or floating charge. In comparison to a mortgage (which is a transfer of title together with a condition for re-assignment on redemption) a charge is a mere encumbrance on the receivables, giving the chargee a preferential right to payment out of the fund of receivables in priority to other claimants. A practical distinction between a mortgage and a charge over receivables is the inability of a chargee to claim a right of action in his own name against the obligor. In practice this distinction is diminished by including a right to convert the charge into a mortgage together with a power of attorney to compel transfer of the receivables to the chargee. Additionally, the statutory rights conferred by Section 101 of the LPA allowing the chargee to appoint a receiver in respect of charges created by deed and the other rights provided to holders of some "qualifying floating charges", provide further enforcement rights for a chargee.

The degree of priority given to a chargee depends on whether the charge is fixed or floating. Whilst definitive definitions have remained elusive, the hallmarks of a fixed charge are that it attaches to the ascertainable receivables over which it is subject immediately upon its creation (or upon the receivable coming into existence). In comparison, a floating charge is a present security over a class or fund of assets (both present and future) which, prior to the occurrence of a specified crystallisation event, can continue to be managed in the ordinary course of the chargor's business. On the occurrence of a specified crystallisation event the floating charge will attach to the assets then presently in the fund, effectively becoming a fixed charge over those assets. Recent case law emphasises control of the receivable as the determining factor in distinguishing a fixed or floating charge whilst asserting that it is the substance of the security created, rather than how described or named, that is important.

The distinction is important: on an insolvency of the chargor, a fixed chargeholder will rank in priority to all unsecured claims whilst a floating chargeholder will rank behind preferential creditors and fixed chargeholders and equally with a statutory "prescribed part" (up to a maximum of £600,000) made available to unsecured creditors; a floating charge given within 12 months (or 24 months if given to a "connected" person) prior to the onset of insolvency will be void except as to new value given; and whereas a fixed chargeholder will obtain an immediate right over definitive assets which can only be defeated by a purchaser in good faith of the legal interest for value without notice of the existing charge (and, as summarised below, as most charges will be registrable or in practice registered, many purchasers will be held to have notice of such charge accordingly), in contrast, disposing of an asset subject

to an uncrystallised floating charge will, apart from certain exceptions, generally result in the purchaser taking the receivables free of the charge.

At the time of writing, the current statutory regime under the Companies Act 2006 (**Companies Act**) for charges created on, or after, 6 April 2013 is a voluntary regime allowing (with some very limited exceptions), within 21 calendar days (beginning with the day following the creation of a charge), the chargor company (registered in England or Wales) or anyone interested in the charge, to register (including in some cases electronically) a statement of particulars of that charge in order to avoid the charge becoming void for lack of registration. This regime will apply whether the charge is over an asset in or outside the UK.

In relation to a mortgage/charge created by an overseas company before 1 October 2011, the mortgage or charge must be registered at Companies House if the company has registered the particulars of an establishment in the UK on the register (in compliance with the statutory requirement to do so), the mortgage/charge is over assets in the UK on the date created and the mortgage/charge is of the type requiring registration. A mortgage/charge created by an overseas company on/after 1 October 2011 over UK assets is not required to be registered at Companies House although such overseas company must, within 21 days of the creation of any mortgage/charge over UK land, ships, aircraft and intellectual property registered in the UK, or any floating charge over any of its property (unless UK property is expressly excluded), enter details of such mortgage/charge on its charges register. This register must be available for inspection, as must copies of the instruments creating any such mortgage/charge.

Where certain security arrangements exist over financial collateral (cash, financial instruments and credit claims) between two non-natural persons, the Financial Collateral Arrangements (No. 2) Regulations 2003 (as amended, including pursuant to the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendments) Regulations 2010 that came into force in England & Wales on 6 April 2011) (the **FCR**) which implement EU Directive 2002/47/EC into English law, disapply certain statutory requirements in relation to that security arrangement (such as the requirement to register security at Companies House under the Companies Act or overseas companies registration requirements noted above as well as certain provisions of English insolvency law).

Except as noted above with regard to the FCR, failure to register a registrable charge within the prescribed statutory period will (both pre and post 6 April 2013) result in that security interest being void as against a liquidator, administrator, creditors in a liquidation or administration or secured creditors. As such, and notwithstanding the potential application of the FCR and the voluntary registration regime from 6 April 2013, mortgages and charges, whether clearly within the categories listed in the Companies Act or potentially financial collateral arrangements, are habitually registered at Companies House. As registration of a charge is a perfection requirement (and not a requirement for attachment of security) an unregistered charge will still be valid as against the chargor, provided the chargor is not in winding-up or administration. Similarly, registration under the Companies Act is not determinative as to priority such that, provided that both charges are registered within the statutory 21-day period after creation, a prior created charge will take priority over a subsequently created charge even where that prior charge is registered second.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of England & Wales, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in England & Wales or must additional steps be taken in England & Wales?**

Notwithstanding the choice of law governing the purchaser's security, the law governing the receivable itself will govern the proprietary rights and obligations between the security holder and the obligor and between the security granter and the security holder (including as to matters of validity, priority and perfection).

The relevant security must therefore be valid and perfected under the laws of England & Wales as well as valid and perfected under the laws of the governing law of the security in order for it to be given effect by the English courts. In addition, English courts will also apply certain mandatory rules of English law which may affect the validity of any foreign law governed security created.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

Security over contractual rights under insurance policies are usually created by security assignment. Security over mortgage or consumer loans will be created by mortgage or charge. Creating security over the mortgage securing a mortgage loan is generally accomplished by equitable mortgage.

Security over marketable debt securities or negotiable instruments (including promissory notes and bearer debt securities) is a complicated area that depends on whether the relevant securities are bearer or registered, certificated, immobilised (i.e. represented by a single global note) or dematerialised and/or directly-held or indirectly-held. In (brief) summary: (i) directly-held and certificated debt securities, where registered, may generally be secured by legal mortgage (by entry of the mortgagee on the relevant register) or by equitable mortgage or charge (by security transfer or by agreement for transfer or charge); (ii) security over bearer debt securities may be created by mortgage or pledge (by delivery together with a memorandum of deposit) or charge (by agreement to charge) and in certain limited circumstances a lien may arise; and (iii) security may be created over indirectly-held certificated debt securities by legal mortgage (by transfer, either to an account of the mortgagee at the same intermediary or by transfer to the mortgagee's intermediary or nominee via a common intermediary) or by equitable mortgage or charge (by agreement of the intermediary to operate a relevant securities account in the name of the mortgagor containing the debt securities to the order/control of the chargee).

The FCR (which remove certain requirements in relation to the creation and registration of security and disapply certain rules of insolvency law) will apply to any security which is a "financial collateral arrangement" involving "financial collateral". See question 5.3 above.

**5.6 Trusts. Does England & Wales recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Trusts over collections received by the seller in respect of sold receivables are recognised under the laws of England & Wales provided that the trust is itself validly constituted.

**5.7 Bank Accounts. Does England & Wales recognise escrow accounts? Can security be taken over a bank account located in England & Wales? If so, what is the typical method? Would courts in England & Wales recognise a foreign law grant of security taken over a bank account located in England & Wales?**

English law recognises the concept of money held in a bank account in escrow. Security granted by a depositor for a third party is typically taken over the debt represented by the credit balance by way of charge or (where the securityholder is not also the same bank at which the cash is deposited) a security assignment. Security over a credit balance granted in favour of the bank at which the deposit is held can only be achieved by way of charge (not by assignment) and is usually supplemented by quasi-security such as a flawed asset arrangement, a contractual right of set-off and a charge in favour of the bank over the depositor's claims for payment of the deposit. To the extent that the security is a security financial collateral arrangement over cash, as provided for in the FCR, those regulations will apply. The security interest is habitually perfected by registration, as mentioned in question 5.3 above.

Foreign-law governed security over a bank account located in England & Wales must be valid under the laws of England & Wales as well as its own governing law in order for it to be given effect by the English Courts.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

This is a complicated question that will depend upon (amongst other things) the nature of the security over the account (whether on its facts it is a fixed or floating charge or a security assignment), whether there are any competing security interests or trust arrangements over the account and the extent of any commingling of cash, whether any security interest is also a security financial collateral arrangement under the FCR and whether the account holder is the subject of insolvency proceedings. Where a security financial collateral arrangement under the FCR exists, the parties may agree the collateral-taker can appropriate the financial collateral, giving the right to become the absolute owner of the collateral should the security become enforceable.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Any charge over the account is likely to be a floating charge rather than a fixed charge on these facts because the chargee is unlikely to have sufficient control over the account in order to create a fixed charge. The ramifications of this distinction are set out in question 5.3 above.

Whether an English law floating charge can be a security financial collateral arrangement under the FCR (with the advantages that this may bring to a chargeholder) has been the subject of recent case law focusing on the FCR requirement that the charged collateral be in the "possession" and "control" of the collateral-taker. In early 2013, the Financial Markets Law Committee established by the Bank of England published a paper urging clarification, but until further judicial or legislative clarification is provided surrounding

the level of rights the collateral provider can retain (i.e. what is the detailed meaning of "rights of substitution" and "withdrawal of excess", which if retained by the collateral provider will not be fatal to the classification of the security as a financial collateral arrangement), there is currently no definitive answer on whether an English law floating charge will constitute a security financial collateral arrangement.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will the insolvency laws of England & Wales automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

Most formal insolvency procedures have an automatic stay of action against the insolvent entity. If the right to the receivables has been transferred by legal assignment, the sale will be perfected, the purchaser will have the right to enforce his assigned rights in his own name and a stay of action on the insolvency of the seller should not affect the purchaser's ability to collect income from the receivables.

If the seller is appointed as servicer for the receivables, the stay of action may prevent the purchaser from taking action to enforce the servicing contract and any proceeds held by the servicer other than in a binding trust arrangement may be deemed to be the property of the servicer, not the purchaser.

If the receivables have been sold by equitable assignment and notice has not been given to an obligor, such obligor may continue to pay the seller. Typically, such proceeds will be subject to a trust in favour of the purchaser. If such a trust has not been imposed on the collections, the purchaser will be an unsecured creditor with respect to such collections.

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

Assuming the receivables have been sold by legal assignment or perfected equitable assignment, an insolvency official appointed over the seller would not be able to prohibit the purchaser's exercise of its rights, unless there had been fraud or another breach of duty or applicable law (such as the antecedent transaction regime described in question 6.3 below).

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in England & Wales for (a) transactions between unrelated parties, and (b) transactions between related parties?**

The insolvency official would need a court order to reverse an antecedent transaction, except for a disposition of property made

after a winding-up petition has been presented (assuming a winding-up order is subsequently made). Such dispositions are void and any receivables purportedly transferred during that period would remain the property of the seller.

Otherwise, the court may set aside a transaction made at an undervalue in the two years ending with the commencement of the administration or liquidation if the company was, at that time, or as a result of the transaction became, unable to pay its debts as they fell due. There is a defence if the court is satisfied that the company entered into the transaction in good faith with reasonable grounds for believing that it would benefit the company. If a transaction at an undervalue is done with the purpose of putting assets beyond the reach of creditors, there is no requirement to prove contemporaneous insolvency and no time limit for bringing court proceedings.

A transaction which puts a creditor or guarantor of the seller into a better position (in a winding-up) than it would otherwise have been in had that transaction not occurred can be set aside by the court if such preference is made: (i) in the two years ending with the onset of insolvency (in the case of a preference to a person “connected” with the company); or (ii) in the six months prior to insolvency (in the case of any other preference). It is necessary to show that a preference was made with a desire to prefer the creditor or guarantor.

---

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

---

The equitable remedy of substantive consolidation, which permits the court to treat the assets and liabilities of one entity as though they were those of another, is not recognised by the English courts. Only in circumstances where the assets and liabilities of two companies were indistinguishably amalgamated together, and where to do so would be in the interests of both companies’ creditors, might the court sanction an arrangement reached by the insolvency official and those creditors.

The separate legal personality of a company will only be ignored in very limited circumstances. Examples include fraud, illegality, where a company is formed to evade contractual obligations or defeat creditors’ claims or where an agency or nominee relationship is found to exist.

---

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in England & Wales, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

---

Where the receivables purchase agreement provides that no further action is required by the seller for the receivables (including receivables arising in the future) to be transferred, the agreement will generally continue to be effective to transfer the receivables even after the initiation of insolvency proceedings. However, either party could exercise a contractual right to terminate.

Further, in certain circumstances, a liquidator might be able to disclaim (and thereby terminate) an ongoing receivables purchase agreement if it were an “unprofitable contract”. Where the agreement requires further action from the seller, the insolvency official may choose not to take that action and, in that situation, the

purchaser’s remedy is likely to be limited to an unsecured claim in any insolvency proceedings.

---

**6.6 Effect of Limited Recourse Provisions. If a debtor’s contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

---

Historically, it has generally been understood that provisions providing that creditors only have limited recourse to the assets of a debtor would be effective in making the debtor insolvency-remote provided that, on the face of the contractual documents, this was the clearly expressed intention of the parties. However, on a recent unopposed application by a debtor to initiate insolvency proceedings (*ARM Asset Backed Securities S.A.* [2013] EWHC 3351 (Ch) (9 October 2013) (*ARM*)), the debtor was held to be insolvent in spite of the fact that its debts were limited in recourse. The judgment has been the subject of much debate and is capable of being limited to its context on a number of factual and legal grounds, but as a result it is currently unclear as to whether an English court would come to a similar conclusion on an opposed and fully argued application.

---

## 7 Special Rules

---

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in England & Wales establishing a legal framework for securitisation transactions? If so, what are the basics?**

---

Other than certain tax laws (see question 9.2 below in relation to special purpose entities which are “securitisation companies” and their treatment for tax purposes), there are no laws specifically providing for securitisation transactions.

**7.2 Securitisation Entities. Does England & Wales have laws specifically providing for the establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

---

There are no laws specifically providing for the establishment of special purpose entities for securitisation (although see question 9.2 below in relation to special purpose entities which are “securitisation companies” and their treatment for tax purposes).

**7.3 Limited-Recourse Clause. Will a court in England & Wales give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

---

Provisions limiting the recourse of a creditor to the net proceeds of disposal or enforcement of specified assets owned by the obligor or its available funds are likely to be valid under English law and an English court is likely to hold that, to the extent of any shortfall, the debt of the obligor is extinguished. Whilst the ARM case referenced in question 6.6 above brought in to question whether a limited recourse provision will be effective to prevent a debtor

being held unable to pay its debts, the judge in the ARM case did seem to confirm the effectiveness of a limited recourse provision as a matter of contract, stating that “the rights of the creditors to recover payment will be, as a matter of legal right as well as a practical reality, restricted to the available assets, and ... the obligations [of the debtor] will be extinguished after the distribution of available funds”.

Where the agreement is governed by a law of another country and the English courts have cause to consider its efficacy under that foreign law, the analysis as to whether such a clause would be upheld will be the same as that discussed in questions 3.4 and 3.5 above, namely that the English courts would apply the foreign governing law to determine whether the limited recourse provision was effective.

---

**7.4 Non-Petition Clause. Will a court in England & Wales give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

---

Non-petition clauses are likely to be valid under English law, although there is little authority. The most effective method for enforcing such a clause would be injunctive relief which, as an equitable remedy, is at the discretion of the court. A court would have to consider whether such a clause was contrary to public policy as an attempt to oust the jurisdiction of the court or the insolvency laws of the UK. It is possible that an English court would deal with a winding-up petition even if it were presented in breach of a non-petition clause. A party may have statutory or constitutional rights to take legal action against the purchaser or such other person which are not possible to be contractually disapplied. Where the agreement is governed by a law of another country and the English courts have cause to consider its efficacy under that foreign law, the analysis as to whether such a clause would be upheld will be the same as that discussed in questions 3.4 and 3.5 above, namely that the English courts would apply the foreign governing law to determine whether the non-petition clause was effective.

---

**7.5 Priority of Payments “Waterfall”. Will a court in England & Wales give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

---

In respect of English law-governed priorities of payments, as a general matter, the courts of England & Wales will seek to give effect to contractual provisions that sophisticated commercial parties have agreed, except where to do so is contrary to applicable law.

The English Supreme Court decision in *Belmont Park Investments Pty Limited v BNY Corporate Trustee Services Ltd and Lehman Brothers Special Financing Inc.* [2011] considered whether a contractual provision subordinating a party’s rights to payment on the occurrence of an insolvency event (termed a “flip clause”) was contrary to applicable English law, specifically the “anti-deprivation” and the “*pari passu*” rules (two sub-sets of a general principle that parties should not contract out of insolvency legislation). The judgment (in which the payment priorities were upheld notwithstanding the fact that the subordination provision was triggered by insolvency of the creditor) put particular emphasis, in deciding whether to give effect to the relevant

provisions, on the importance of party autonomy and the desire of the courts to give effect to agreed contractual terms, as well as consideration of whether the relevant subordination provisions were commercially justifiable and entered into in good faith or whether they evidenced an intention to evade insolvency laws.

By contrast, the US Bankruptcy Court has held in parallel proceedings that the English law governed “flip clause” in question was unenforceable as a violation of the US Bankruptcy Code, resulting in competing decisions in the UK and the US and in uncertainty as to whether an adverse foreign judgment in respect of the enforceability of a priority of payments “waterfall” would be recognised and given effect by the English courts in the context of a cross-border insolvency case.

Where the priority of payments is governed by a law other than the laws of England & Wales and the English courts have cause to consider its efficacy under that foreign law, the analysis as to whether such a clause would be upheld will be the same as that discussed in questions 3.4 and 3.5 above, namely that the English courts would apply the foreign governing law to determine whether the priority of payments was effective.

---

**7.6 Independent Director. Will a court in England & Wales give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

---

A restriction or limitation on the ability of the directors to bring insolvency proceedings contained in the articles of association of a company or in a contract entered into by a company may be invalid as a matter of public policy or incompatible with certain statutory duties of the directors.

---

## 8 Regulatory Issues

---

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in England & Wales, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in England & Wales? Does the answer to the preceding question change if the purchaser does business with other sellers in England & Wales?**

---

A purchaser of consumer receivables requires a licence under the CCA. A purchaser of residential mortgage loans who assumes a servicing and collection role with respect to such mortgage loans will require authorisation from the FCA. The purchaser may also be obliged to register under the Data Protection Act 1998 (the DPA). It makes no difference whether or not the purchaser does business with other sellers in England & Wales.

---

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

---

The seller is likely to need: (i) a licence from the OFT under the CCA (and, following the transfer of responsibility to the FCA on 1

April 2014, permission from the FCA to conduct certain credit-related regulated activities (e.g. debt collection)), since debt collection is a business that requires a consumer credit licence; and (ii) registration under the DPA. Where the seller continues to act as servicer with respect to second-charge residential mortgage loans which are captured by consumer credit legislation (first-charge mortgage credit is subject to a separate FCA regime) it will be required to be authorised to perform such a role by the FCA. Any standby or replacement servicer will require the same licences and authorisations, before taking any action to enforce or collect monies owed under regulated credit agreements.

---

**8.3 Data Protection. Does England & Wales have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

---

The handling and processing of information on living individuals is regulated by the DPA. The DPA only applies to personal data, so it affects data on individual living obligors and not enterprises. The DPA specifies that a data controller is any legal person who determines the purposes for which, and the manner in which, any personal data is to be processed, and so may well include a purchaser of receivables serviced by the seller. A data controller in the UK must register (known as notification) with the Information Commissioner's Office unless limited exemptions apply.

---

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of England & Wales? Briefly, what is required?**

---

Performance of certain functions in relation to regulated consumer credit or consumer hire agreements will, from 1 April 2014, require permission from the FCA to conduct the relevant credit-related regulated activities (e.g. exercising, or having the right to exercise the lender's rights and duties under a regulated credit agreement).

The CCA (and certain pieces of delegated legislation made pursuant to it) will continue to govern consumer credit agreements and contain several important requirements for lenders/owners under regulated consumer credit/hire agreements.

The UTCCR applies to agreements made on, or after, 1 July 1995. A term is "unfair" if it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer. Such an unfair term will not be binding on the consumer.

The Unfair Contracts Terms Act 1977 restricts the limitation of liability by a party. Liability for death or personal injury caused by negligence cannot be limited and any clauses that limit liability for other damage caused by negligence must satisfy a reasonableness test.

Mortgage contracts are regulated by the Financial Services and Markets Act 2000 (the FSMA). Entering into a regulated mortgage contract, arranging or administering it or advising on it is a regulated activity, requiring authorisation from the FCA under FSMA. Second mortgages and buy-to-let mortgages are currently excluded from "regulated mortgages" but will require a licence from the OFT under the CCA (and, following the transfer of responsibility to the FCA on 1 April 2014, from the FCA). First-charge mortgage lenders authorised under FSMA are required to comply with the FCA's *Mortgages: Conduct of Business* handbook. From 1 April 2014, second-charge mortgage lenders will also be required to comply with the FCA's consumer credit sourcebook, CONC.

The Consumer Rights bill seeks to harmonise domestic legislation in relation to consumer protection legislation in the UK. The current draft of the bill (which is undergoing parliamentary scrutiny and debate), contains important provisions relating to unfair contract terms.

---

**8.5 Currency Restrictions. Does England & Wales have laws restricting the exchange of the currency of England & Wales for other currencies or the making of payments in the currency of England & Wales to persons outside the country?**

---

No, subject to any restrictions imposed by United Nations sanctions.

---

## 9 Taxation

---

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in England & Wales? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

---

The withholding tax treatment of UK receivables depends not only on their nature but on the nature of the recipient to whom they are paid. Very broadly, payments of interest with a UK source may be paid without withholding to a purchaser which is either resident in the UK or carries on business in the UK through a permanent establishment. Payments of interest to a non-UK resident purchaser may often be subject to withholding subject to any available treaty relief pursuant to a double taxation convention. Generally, although there have been some recent administrative advances, the use of relief under a double taxation convention where there are pools of assets that run to more than a very few obligors may be administratively challenging. Accordingly loan receivables are typically securitised through the use of a UK resident purchasing company.

Generally trade receivables payments and lease rental payments are not subject to UK withholding unless they provide for the payment of interest, in which case the interest element will be subject to withholding in the same way as interest on loan relationships. The recharacterisation of deferred purchase price as interest depends upon the facts of the case in question, but is not a typical outcome under the UK rules.

---

**9.2 Seller Tax Accounting. Does England & Wales require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

---

The tax treatment of a company within the charge to UK corporation tax would be expected, at least as a starting point, to follow its accounting treatment. For a company purchasing receivables, in many cases the rules imposed by the appropriate accounting regime would be expected to result in the creation of accounting profits, and accordingly taxable profits, which do not reflect the actual cash position of the company in question.

For accounting periods commencing on, or after, 1 January 2007, the Taxation of Securitisation Companies Regulations are in force. These regulations apply to companies which are “securitisation companies” (as defined in the regulations) and permit such securitisation companies to be subject to tax treatment reflecting the cash position of its securitisation arrangements such that it is taxed only on the cash profit retained within the company after the payment of its transaction disbursements according to the transaction waterfall. As such, balanced tax treatment can be achieved and the regime has been seen as providing effective relief from the complex or anomalous tax rules which could otherwise apply to UK incorporated special purpose vehicles.

---

### 9.3 Stamp Duty, etc. Does England & Wales impose stamp duty or other documentary taxes on sales of receivables?

---

Stamp duty exists in the UK and is chargeable on documents in certain circumstances. Transactions effected without the use of a document may also be subject to UK Stamp Duty Reserve Tax (SDRT) levied on transfers of certain types of securities whether by document or otherwise. Generally, transfers of loans (which are not convertible and have no “equity” type characteristics such as profit-related interest), trade and lease receivables should not be subject to UK stamp duty or SDRT.

---

### 9.4 Value Added Taxes. Does England & Wales impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

---

UK value added tax (VAT) is chargeable on supplies of goods and services which take place in the UK and which are made by “taxable persons” in the course or furtherance of a business. The standard rate of VAT is currently 20 per cent., although certain supplies (including the supply of certain financial services) are exempt from VAT.

In *MBNA Europe Bank Ltd v HMRC* [2006] it was decided by the UK High Court that the transfer of credit card receivables by an originator in a securitisation was not a supply for VAT purposes. However, that decision may not apply to all such transfers. To the extent that the decision does not apply, a transfer of financial receivables would generally be treated as an exempt supply for VAT purposes.

Generally, fees payable for collection agent services are not exempt from VAT and will usually give rise to VAT at the standard rate, to the extent they are treated as taking place in the UK.

---

### 9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

---

As described above, the transfer of financial receivables would usually either constitute an exempt supply for VAT purposes, or fall outside the scope of VAT altogether. However, a seller might incur VAT on a supply of assets which does not fall within any of the exemptions: for example, property or trading assets on a true sale securitisation. If so, the seller would generally be liable to account for such VAT to H.M. Revenue & Customs (HMRC).

Broadly, HMRC would not be able to require the purchaser to account for VAT unless the purchaser was a member of the same group as the seller for VAT purposes. Although there are limited exceptions to this general position, it is unlikely that such exceptions would apply in a securitisation context.

Where charged, stamp duty and SDRT are generally payable by the purchaser.

---

### 9.6 Doing Business. Assuming that the purchaser conducts no other business in England & Wales, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in England & Wales?

---

Generally, the purchase of receivables will not give rise to tax liabilities for a purchaser conducting no other business in the UK, and the appointment of a servicer by the purchaser which carries out normal administrative activities on its behalf should not result in tax liabilities for the purchaser. The question of enforcement is more complex and the particular circumstances would need to be considered carefully.



**Rupert Wall**

Weil, Gotshal & Manges  
110 Fetter Lane  
London EC4A 1AY  
United Kingdom

Tel: +44 20 7903 1364  
Fax: +44 20 7903 0990  
Email: [rupert.wall@weil.com](mailto:rupert.wall@weil.com)  
URL: [www.weil.com](http://www.weil.com)

Rupert is a partner in the structured finance practice of Weil's London office with long-standing expertise in securitisation, structured finance, and derivatives.

He has experience structuring and leading securitisation deals across a diverse range of asset classes (including trade receivables, credit-card receivables, auto-loans, vehicle rental fleets and residential and commercial mortgage loans), encompassing a wide range of structures (including CDO/CLOs, RMBS, CMBS, ABCP conduits, covered bonds and whole business structures) and has advised a number of financial and structuring institutions, originators, arrangers, underwriters, trustees and credit enhancers in complex cross-border financing transactions.

Rupert's full professional profile is available at: [www.weil.com/ruPERTwall/](http://www.weil.com/ruPERTwall/).

**Jacky Kelly**

Weil, Gotshal & Manges  
110 Fetter Lane  
London EC4A 1AY  
United Kingdom

Tel: +44 20 7903 1045  
Fax: +44 20 7903 0990  
Email: [jacky.kelly@weil.com](mailto:jacky.kelly@weil.com)  
URL: [www.weil.com](http://www.weil.com)

Jacky is head of Weil's London structured finance practice. She has been practising since the mid-eighties when the UK securitisation market was conceived.

She has represented both banks and corporate clients on the securitisation of a wide range of asset types in some of the most innovative deals in the market, including ports revenues, residential mortgages, commercial real estate, trade receivables, credit cards, computer/equipment leases, auto loans, HP receivables and music royalties as well as football ticket and stadium financing. Jacky also has extensive experience in CLO/CDOs, SIVs, ABCP conduits and covered bonds. Chambers UK 2014 states that Jacky "is a 'prominent and well-regarded' name in the market" and is recognised for "her substantial expertise", whilst Chambers UK 2013 states that she is "identified by sources as an impressive presence in the field" and has "led the team on a number of high-value and significant transactions".

Jacky's full professional profile is available at: [www.weil.com/jackykelly/](http://www.weil.com/jackykelly/).

## Weil

Weil's London structured finance team has consistently been at the forefront of developments in the structured finance, securitisation and derivatives industry. In 2013, the team acted on around 25 per cent. of the new CLO 2.0 issuances to come to market, together with continued involvement in significant and often innovative auto loan, ABCP conduit, whole business, residential mortgage and credit card securitisations.

Chambers UK has described the Weil structured finance team as "a diverse practice that offers in-depth knowledge across an array of product areas" and as "diligent, responsive and knowledgeable", whilst The Legal 500 UK notes that that the team is "known for innovative and complex bespoke structures".

Weil is one of the only English law firms able to offer access to full service, best-in-class US advice, particularly with regard to specialist areas which impact on new structured finance products being issued and placed in Europe and/or the US (such as the Capital Requirements Regulation, CRA 3, Dodd-Frank, ERISA, FATCA, the Investment Company Act and the Securities Act).

# France

Hervé Touraine



Lauren Gauriot



Freshfields Bruckhaus Deringer LLP

## 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

As a general principle of French law, it is not necessary that the seller and the debtor enter into a formal receivable contract to evidence the sale of goods or services. Therefore, invoices, a historic relationship or any other type of exchange of consent between the seller and the debtor, including by oral agreement, is sufficient to evidence a valid debt obligation.

Notwithstanding the foregoing, the enforceability of the debt obligation of the debtor to the seller is a question of evidence. Under French law, rules of evidence are different depending on the status of the parties and of their relationship.

In summary, evidence of a relationship between commercial parties (i.e. business entities) can be brought by any means. In this respect, invoices or durable business relationships can be regarded as perfectly relevant presumptions of the existence of a contract and therefore of a perfected debt obligation. Between non-commercial parties (i.e. individuals), a written document is necessary to prove the existence of a contract of an amount greater than EUR 1,500. Finally, if the relationship is entered into between a commercial party and a non-commercial party, the non-commercial party shall have the right to produce evidence of a contract and therefore of a perfected debt obligation by any means, whereas the commercial party may only use the rules of the French Civil Code.

**1.2 Consumer Protections. Do France’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

Under the French Monetary and Financial Code, a loan granted to a consumer shall not carry an interest rate higher than a specified interest rate (*taux d’usure*). If the interest rate does exceed such a limit, the bank, having granted the loan, is liable to a penalty of up to two years’ imprisonment or a fine of up to EUR 45,000. However, such a limit does not apply to corporate loans or loans granted to professionals under certain conditions.

As regards interest on late payments, the French Civil Code provides a statutory right to interest on late payment at a minimum interest rate fixed by governmental decree on an annual basis.

A loan granted to a consumer involves certain risks for the lenders, in particular under the provisions of the French Consumer Code. Pursuant to those provisions (*procédures de surendettement et de rétablissement personnel*), a consumer may request and obtain, from a competent court, a moratorium and/or reduction of its debt and related interest. Moreover, under certain circumstances and conditions, the consumer having borrowed money from a credit institution may obtain the outright cancellation of its entire debts owed to such credit institution.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

French law authorises the sale of receivables to a debtor which is a public body, including the government or a government agency.

A sale of receivables to a public entity is not subject to specific principles. However, it is worth noting that the provisions relating to the sale of receivables shall be combined with the specific rules applicable to such public entities.

As regards the validity of a sale of receivables itself, it must be notified to the public accountant (*comptable public*) of the public entity to which the receivable contract refers, and must be accompanied with the single original (*exemplaire unique*) of the receivable contract, where such a contract is a public procurement.

Furthermore, the French Daily Law expressly refers to public bodies. Under the French Daily Law, the debtor may officially accept the sale of its debt to a third party. Such an acceptance creates a direct relationship between the debtor and the purchaser and must be duly authorised by the deliberative assembly where the debtor is a public body. In the specific context of public-private partnership agreements, the French Monetary and Financial Code provides that such an agreement may stipulate that certain receivables relating to the investment costs of a project are irrevocable once the public debtor has stated that such investments have been made. As a consequence, after the transfer of such receivables to the purchaser, it is prohibited for the debtor to set off the fraction of receivable which relates to the investment costs against any other debt.

It is a long-standing principle that enforcement procedures provided by the French Code of Civil Procedure cannot be implemented against any public entity. Therefore, the enforcement of a sale of receivables against any public debtors will be subject to specific

administrative proceedings (the Purchaser shall ask Administrative Courts to order an injunction, a periodic penalty payment or a fine).

## 2 Choice of Law - Receivables Contracts

### 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in France that will determine the governing law of the contract?

France has ratified the Rome Convention, dated 19 June 1980 on the law applicable to contractual obligations (the *Rome Convention*), which has been implemented in Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (the *Rome I Regulation*). According to the Rome I Regulation, when the parties do not specify a choice of law, the receivables contract shall be governed by the law of the country with which it is “most closely connected”. Except in the case of certain consumer contracts, it is presumed that the receivables contract is “most closely connected” with the country where the party *effecting the performance which is characteristic of the contract* has, at the time the contract is concluded, its central administration.

However, if the receivables contract is entered into in the course of that party’s trade or profession, that country is deemed to be the country in which the principal place of business is situated or, where under the terms of the receivables contract the performance is to be effected through a place of business other than the principal place of business, the country in which that other place of business is situated.

### 2.2 Base Case. If the seller and the obligor are both resident in France, and the transactions giving rise to the receivables and the payment of the receivables take place in France, and the seller and the obligor choose the law of France to govern the receivables contract, is there any reason why a court in France would not give effect to their choice of law?

The Rome I Regulation applies, subject to certain exceptions, to commercial or civil contractual obligations in any situation involving a choice between the laws of different countries, to the extent such countries are Member States of the EEA and are subject to the Rome I Regulation. In relation to the base case above, there would be no conflict of laws in the absence of relevant elements of foreign law. Under the provisions of the French Civil Code, the French law chosen by the seller and the debtors in the receivable contracts will become the mandatory law applying to their relations and such choice will be recognised as a valid choice of law by a French court.

### 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in France but the obligor is not, or if the obligor is resident in France but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in France give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

According to the Rome I Regulation, a contract shall be governed by the law chosen by the parties. Thus, the seller and the debtor are free to choose a law other than French law to govern the receivable

contract and the receivables. However this is with the proviso that, where all the other elements relevant to the situation at the time of the choice are connected with France only, such choice of law will not prejudice the application of mandatory rules (*ordre public*) in France.

Assuming that the debtor is not resident in France, the Rome I Regulation would apply to the potential conflict of laws between the law of the country where the debtor is situated and French law, being the law of the country where the seller is situated and the law governing the receivables contract. According to the Rome I Regulation, the seller and the debtor are free to choose French law to govern the receivables contract. Therefore, choosing French law to govern the receivables contract will be recognised as a valid choice of law by a French court.

Assuming the seller is not resident in France, the Rome I Regulation would apply in the same terms as described in the above paragraph. Therefore, the choice of French law to govern the receivables contract will be recognised as a valid choice of law by a French court.

### 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in France?

The United Nations Convention on the International Sale of Goods was ratified by France on 27 August 1981 and entered into force on 1 January 1988.

## 3 Choice of Law - Receivables Purchase Agreement

### 3.1 Base Case. Does France’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., France’s laws or foreign laws)?

French law does not require the sale of receivables to be governed by the same law governing the receivables. Pursuant to article 14 of the Rome I Regulation, the law applicable to the sale of receivables can be freely chosen by the seller and the purchaser of the receivables. However, article 14 provides that the law governing the receivables will determine a certain number of important elements such as: the possibility to assign the receivable, the relationship between the assignor and the debtor, the requirements for the assignment to be enforceable, and the characteristics of a satisfactory payment by the debtor.

### 3.2 Example 1: If (a) the seller and the obligor are located in France, (b) the receivable is governed by the law of France, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of France to govern the receivables purchase agreement, and (e) the sale complies with the requirements of France, will a court in France recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

A French court will recognise such a sale as effective against the seller, the obligor and other third parties. This, however, assumes that the purchaser is duly authorised to acquire receivables in France (see question 8.1) and that the law applicable to it would not conflict with French law. The insolvency administrator is not normally considered as being a third party. It may have some grounds to invalidate an assignment of receivables in certain

circumstances (see question 6.3) but it is the continuation of the seller and, therefore, it is bound by the assignment to the same extent as the seller.

**3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside France, will a court in France recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?**

Assuming that the Rome I Regulation is applicable, such assignment would be valid between the seller and the purchaser and enforceable against the obligor. With regard to the enforceability against third parties not being dealt with by the Rome I Regulation, depending on the countries involved, the situation will be unclear and potentially difficult to resolve. The same assumptions as that referred to in question 3.2 will apply.

**3.4 Example 3: If (a) the seller is located in France but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in France recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with France's own sale requirements?**

The answer to this question is similar to the answer to question 3.3.

**3.5 Example 4: If (a) the obligor is located in France but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in France recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with France's own sale requirements?**

The answer to this question is mainly dealt with by the laws of the relevant country. Should this country be France, the answer to this question is similar to the answer to question 3.3.

**3.6 Example 5: If (a) the seller is located in France (irrespective of the obligor's location), (b) the receivable is governed by the law of France, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in France recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in France and any third party creditor or insolvency administrator of any such obligor)?**

Assuming that the Rome I Regulation is applicable, such assignment would be valid between the seller and the purchaser.

However, should the requirement for the sale being enforceable against the obligor under the law of the purchaser's country and under the law governing the receivable differ, such assignment might not be enforceable against said obligor. In such an example, with regard to the enforceability against third parties not being dealt with by the Rome I Regulation, depending on the countries involved, the situation will be unclear and potentially difficult to resolve. Note that the same assumptions as that referred to in question 3.2 will apply.

## 4 Asset Sales

**4.1 Sale Methods Generally. In France what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

Firstly, several conditions must be complied with in respect of the receivables that are intended to be sold by a seller to a purchaser:

- (a) the receivables must exist now or in the future;
- (b) the receivables must belong to the seller; and
- (c) the receivables must be identified and individualised or be capable of being identified and individualised.

Secondly, the status of the purchaser determines the method of sale and the conditions for the sale of the receivables. In this respect, the sale of the receivables must take the form of:

- (i) an assignment under the common regime of articles 1689 *et seq.* of the French Civil Code. The sale is valid between the seller and the purchaser but enforceable against third parties, subject to either the debtors being notified of the sale by a court bailiff (*voie d'huissier*) or the acceptance of the sale by the debtors in a deed executed before a public notary (*acte authentique*). Assuming that the debtor is identified, there are no restrictions in respect of the type of receivables that can be assigned pursuant to the relevant provisions of the French Civil Code or in respect of the status of the purchaser. Given the costs related thereto (around EUR 250 per debtor if a notification is served by court bailiff), this method of assignment is not often used in the context of securitisation transactions;
- (ii) an assignment by way of subrogation pursuant to articles 1249 *et seq.* of the French Civil Code. Under this method, a third party (the *subrogé*) pays the initial creditor (the *subrogeant*) and takes over the initial creditor's rights against the debtor. The subrogation must be express and must occur at the time of the payment. As from the date of the subrogation, which shall coincide with the delivery of a formal receipt by the initial creditor to the third party (*quittance subrogative*), the transfer of the initial creditor's rights against the debtor to the third party shall be effective and enforceable against the debtor without any further formalities. Assuming that the debtor is identified, there are no restrictions in respect of the type of receivables that can be assigned by way of subrogation or in respect of the status of the purchaser. However, the initial creditor's rights against the debtor shall be transferred to the new creditor only up to the amount paid by it. In the context of a securitisation transaction, the constraints of the date of the subrogation and of the amount paid at the time of the subrogation may raise issues in connection with the sale of receivables with a discount purchase price or a deferred purchase price;
- (iii) an assignment under the French Daily Law pursuant to articles L. 313-23 to L. 313-34 of the French Monetary and Financial Code. The assignment of the receivables is performed by way of a single transfer document (*acte de*

*cession*) exchanged between the seller and the purchaser. The assignment is effective between the parties and enforceable against third parties as from the date affixed by the purchaser on such transfer document without any further formalities. The provisions of the French Monetary and Financial Code have been amended in connection with the Dailly Law to secure the sale of future receivables and to develop the sale of receivables in the context of international financing transactions. Despite these recent evolutions, there are still some restrictions as to the type of receivables that can be sold under this method and as to the status of the purchaser. The receivables must arise from a “professional” relationship between the seller and the debtor, and the purchaser must be a credit institution duly licensed in France or an EU-passported credit institution;

- (iv) an assignment under the French Securitisation Law pursuant to articles L. 214-167-I to L. 214-190 of the French Monetary and Financial Code. The assignment of the receivables is performed by way of a single transfer document (*bordereau*) exchanged between the seller and the purchaser. The assignment is effective between the parties and enforceable against third parties as from the date affixed on such transfer document without any further formalities. As for the method of assignment referred to in (iii) above, the provisions of the French Monetary and Financial Code allow the sale of future receivables and the sale of receivables in the context of international securitisation transactions. There are no restrictions as to the type of receivables that can be sold under this method. However, the purchaser must be a French *fonds commun de titrisation* or *FCT*, which is a co-ownership entity without legal personality jointly created by a management company and a custodian. There are many advantages in using this method, including the fact that all related security interests in connection with the purchased receivables are automatically transferred to the FCT without any further formalities, and that the FCT is the only French entity qualifying as a bankruptcy-remote vehicle for rating purposes. Alternatively, the purchaser may be set up under the form of a securitisation company (*société de titrisation* or *SDT*). In this case, the SDT is a commercial company benefiting from the same rules as for a FCT but being subject to a different tax treatment. From experience, an FCT or an SDT is the ideal tool for international securitisation transactions; or
- (v) in the case of mortgage loan receivables or receivables on public entities, it should be noted that another method of assignment is provided by articles L. 515-13 *et seq.* or in case of mortgage loans receivables only, articles L.515-34 *et seq.* of the French Monetary and Financial Code. Basically, the conditions and procedures of the assignment are the same as the assignment under the French Dailly Law or the French Securitisation Law. However, the Purchaser must be a mortgage company (*société de crédit foncier* (*SCF*) or a *société de financement de l'habitat* (*SFH*)), which are French financial institutions licensed by the French banking authorities with a limited purpose and structured as bankruptcy-remote entities.

The terminology varies; transfer, sale or assignment are terms that are frequently used. From a legal perspective, these are equal.

---

#### 4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

---

In order for the sale of receivables to be perfected against third parties, including any later purchaser, the formalities required under

the various methods of assignment described in question 4.1 must be complied with. In this respect, the only method of assignment that will require the performance of formalities is the assignment under the general regime of the French Civil Code (i.e. debtors being notified by way of a court bailiff or acceptance of the assignment by the debtors in a deed executed before a public notary).

---

#### 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

---

Generally speaking, the requirements for the sale and perfection of mortgage loans, consumer loans, promissory notes or debt securities are the following:

- (i) promissory notes are transferred by way of endorsement for the benefit of a credit institution; the endorsement transfers the underlying debt to the new holder of such promissory notes;
- (ii) marketable debt securities are transferred by way of a transfer order (*ordre de mouvement*); and
- (iii) mortgage loans and consumer loans are transferred in accordance with question 4.1 without the debtor's consent depending on the method of assignment, and the transfer of the mortgage securing the loans must be registered in the name of the purchaser (except under certain circumstances if the mortgage loans are materialised by specific instruments such as *copie exécutoire à ordre*).

However, if the sale of the instruments referred to in (iii) above is performed under the provisions of the French Dailly Law, the French SCF Law, the French SFH Law or the French Securitisation Law to a credit institution, a SCF, a SFH, a FCT or a SDT, then there are no formalities required in order to transfer the mortgage or other security interests securing the loans.

---

#### 4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

---

Whether or not the notification and/or the consent of the debtors are required for the sale to be enforceable against the debtors will depend on the method of the assignment. Under the common regime of the French Civil Code, the sale will be enforceable against the debtors upon a notification being served on them by a court bailiff. Under the French Dailly Law or the French Securitisation Law, the sale will be enforceable against the debtors as from the date of the sale without any requirement to notify them. In all situations, notification of the assignment to the debtor freezes the right of set off, (if any) of the debtor against the purchaser.

Under French law, in the absence of any provision of the receivables contract expressly prohibiting assignment, the receivables may be freely assigned even without the consent of the debtors, except in respect of the receivables for which French law prohibits the assignment (e.g. receivables relating to alimony).

In addition, the French Commercial Code (article L.442-6-II-c) provides that any clause of the receivables contract prohibiting the assignment to any third party of the receivables arising from such contract is null and void if such receivables contract is entered into between commercial parties (which exclude receivables contracts entered into with consumers).

However, the parties may still contractually limit the assignability of the receivables arising from the receivables contract, for instance by stating that a party will only be allowed to assign the said receivables after having obtained the consent of the other party as to the identity of the assignee.

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

Apart from the French Dailly Law which provides for a specific notification form, the form of notice is not regulated. In all cases, it must be in writing and detailed enough to make it clear which receivables have been sold, especially in relation to future receivables. It is generally agreed that the notification of the debtor after the opening of insolvency proceedings against the seller is ineffective if the assignment took the form of the common regime of articles 1689 *et seq.* of the French Civil Code. When other legal means of assignment (see question 4.1) are used, notification of the debtors can validly be made after the bankruptcy of the seller.

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that "None of the [seller]'s rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?**

The presence of a provision contract to the effect that "*None of the [seller]'s rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]*" in a receivables contract may restrict the assignment of the relevant receivables. The consent from the other party to the receivables contract will be necessary in order to assign the receivables deriving from the execution of the receivables contract.

However, if the provision of the receivables contract only prohibits the assignment of the agreement, it might be considered that such prohibition is limited to the assignment of the agreement itself and not to the assignment of the receivable.

In any case, and beyond the wording, the parties' intention must be taken into consideration in the construction of the clause. In particular, key questions to be considered will concern the purpose of the clause: who is protected by this clause? what confidential information is at stake?

This is subject, in all cases, to the provision in our answer to question 4.7.

**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in France? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If France recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

The French Commercial Code (article L.442-6-II-c) provides that any clause of the receivables contract prohibiting the assignment to any third party of the receivables arising from such contract is null and void if such receivables contract is entered into between commercial parties (which exclude a receivables contract entered into with consumers). However, the parties may still contractually limit the assignability of the receivables arising from the receivables contract, for instance, by stating that a party will only be allowed to assign the said receivables after having obtained the consent of the other party as to the identity of the assignee. Such provisions are valid but will not be enforceable against the purchaser if it cannot be proven that the latter was aware of the existence of such a restriction.

If (i) the receivables contract is entered into between the seller and a non-commercial party (i.e. customer) or if the receivables contract contains provisions limiting the assignability of the receivables, for instance by stating that a party will only be allowed to assign the said receivables after having obtained the consent of the other party as to the identity of the assignee, and (ii) the purchaser is aware, as at the date it purchased the receivables, of the existing restrictions as to the assignment of the receivables, it might, pursuant to the provisions of the French Civil Code and according to certain French court decisions, be liable for any damage caused to the debtors for having knowingly contributed to the violation of the provisions agreed to between the seller and debtors.

Moreover, in such a case, the fact of having assigned the receivables without prior consent of the debtors would constitute a breach of contract by the seller. Such contractual breach could give rise to a claim for damages of the debtors against the seller pursuant to the provisions of the French Civil Code. The debtors having a claim against the seller, together with any consequent set-off right, may cause the debtors to be or become non-eligible for the assignment.

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

Assuming that the sale of the receivables is performed in accordance with the provisions of the French Dailly Law, the French SCF Law, the French SFH Law or the French Securitisation Law to a credit institution, a SCF, a SFH, a FCT or a SDT, the sale document (acte de cession) must contain the following mandatory information:

- (a) references to the relevant provisions of the law that governs the sale document;
- (b) identification of the purchaser; and

- (c) identification of each receivable subject to the sale document; each receivable must be sufficiently identified and individualised in precise detail, for instance the designation of the debtor, the amount or the maturity of the receivable (this list being given as an example by the law). When the sale is made by a computerised process (*procédé informatique*) that allows the identification of receivables, then the sale document shall only mention the means by which the receivables are transferred, identified and individualised and an estimate of their number and total amount.

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

Under French law, the courts are not bound by the qualification given by the parties. Pursuant to article 12 of the French Civil Procedure Code, it is up to the judge to give or restore the qualification of an agreement, without taking into account the qualification given by the parties. In doing so, the judge will analyse the agreement and its core elements, and its “*économie*”, i.e. the reciprocal obligations of the parties.

In relation to perfection, the sale of receivables is perfected under the various methods of assignment described in question 4.1, subject to the completion of the relevant formalities. Upon such formalities (e.g. execution of the transfer document under the French Dailly law, the French SCF, the French SFH or the French Securitisation Law), the receivables cease to belong to the seller and are legally transferred to the purchaser. The fact that the seller retains certain risks (credit, interest rate, dilutions, etc.) and may, to a certain extent, (i) control the collections received in its capacity as servicer on behalf of the purchaser, and (ii) have a right to repurchase some of the receivables, has no impact on the perfection of the sale.

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

French securitisation transactions are generally structured to provide a commitment from the seller to assign over a certain period of time (revolving period) all or part of the receivables it owns. Such commitment is enforceable against the seller until its insolvency. Upon insolvency of the seller, the insolvency official will have the option either to continue or to terminate such commitment depending on the circumstances. The option of the insolvency official is, however, subject to a formal procedure set out by the French Commercial Code.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?**

The French Securitisation Law specifically provides that the sale of the receivables that come into existence after the date of the sale

contract is not affected by the commencement of insolvency proceedings against the seller. According to the French Securitisation Law, the sale is perfected on the date of execution of the transfer document irrespective of the date on which the receivables come into existence (*date de naissance*), the date on which they become due (*date d’échéance*) or the date on which they become due and payable (*date d’exigibilité*), including upon an insolvency proceeding of the seller.

The French Securitisation Law has been amended a number of times over the years, in particular, in order to ease the assignment of future receivables and to ensure enforceability, even in relation to future receivables which are sold before, but which come into existence after, bankruptcy of the seller. Thus, the law includes crystal clear provisions to that effect and no specific legal structuring is necessary.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

Assuming that the sale of receivables is performed under the French Dailly law, the French Securitisation Law, the French SCF Law or the French SFH Law, all related security and ancillary rights will be automatically, and without formality (*de plein droit*), transferred to the purchaser, including in respect of mortgages or other registered security interest. Such transfer will be enforceable as from the date of the sale of the receivables.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

In case of an assignment of receivables governed by articles 1689 *et seq.* of the French Civil Code (as described in question 4.1), the obligor will, as a matter of principle, be entitled to use its set-off rights if the legal conditions of set-off between the obligor and the seller were complied with before the notice of sale made to the obligor.

A similar solution will prevail in the context of a Dailly Law assignment (as described in question 4.1). Indeed, after the obligor has received a notice of assignment (*notification*), the set-off rights may not be opposed anymore to the purchaser by such obligor, except in relation to connected claims (*créances connexes*). In any case, if such obligor has accepted the assignment through a formal acceptance (*acceptation*) (pursuant to article L.313-29 of the French Monetary and Financial Code), he will not be entitled to oppose to the purchaser any defence (including set-off) deriving from its personal relationship with the seller.

A similar solution will apply *mutatis mutandis* to an assignment under the French Securitisation Law governed by articles L.214-168 *et seq.* of the French Monetary and Financial Code, although the law does not provide for a formal acceptance procedure (*acceptation*).

## 5 Security Issues

### 5.1 Back-up Security. Is it customary in France to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

It is not customary in France to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security. To our knowledge, subject to “covered bond”-type structures, no securitisation transaction implemented in France has used such mechanism to secure the risk that a sale of receivables is deemed by a court not to have been perfected.

### 5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of France, and for such security interest to be perfected?

See the answer to question 5.1.

### 5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in France to grant and perfect a security interest in purchased receivables governed by the laws of France and the related security?

The French Civil Code provides for a simple procedure to pledge receivables. Such pledge must take the form of a written agreement which identifies the pledged receivables (or which includes the means of identification of the receivables in case of future receivables). Such pledge is valid between the pledgor and the pledgee and enforceable against third parties upon signing. It is enforceable against the debtors only upon notification.

The so-called “financial guarantee regime”, resulting from the European Directive on financial collateral, provides for an even more simplified regime which resists bankruptcy of the pledgor but which is only available to financial institutions (which include, for the purpose of this specific regime, French securitisation vehicles).

### 5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of France, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in France or must additional steps be taken in France?

It is generally agreed that a pledge over French assets should be governed by French law. Accordingly, the situation described in this question is to be avoided.

### 5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Under French law, depending on the type of assets and the legal status of the pledgor and the pledgee, additional or specific formalities might be required on a case-by-case basis.

### 5.6 Trusts. Does France recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

France has not yet ratified the 1985 international convention relating to the law applicable to trusts and their recognition. Accordingly, trusts are generally not recognised under French law, bearing in mind that the situation evolves slowly; in particular, trusts have been expressly mentioned in recent tax laws, and a court decision known as the “*Belvédère*” case recently recognised the capacity of a trust to represent creditors in the context of a parallel debt. In addition, a similar concept has been recently introduced into the French Civil Code. The *fiducie* is a mechanism which allows a party (*constituant*) to isolate assets into a special-purpose fund (the *fiducie*) which is managed by a fiduciary (*fiduciaire*) to the benefit of the *constituant* or a third party beneficiary. The *fiducie* is an agreement. This mechanism is generally not used in connection with securitisation transactions. A *fiducie* is either set up for assets management purposes or as a security.

The French Securitisation Law has introduced a mechanism to secure the collections received by the seller in connection with the sold receivables. Pursuant to articles L. 214-172 and D. 214-228 of the French Monetary and Financial Code, specially dedicated bank accounts are set up in the books of the collection account banks of the seller to receive the collections in respect of the sold receivables and whereby the seller agrees to specially dedicate the collection accounts to the FCT or the SDT. Consequently, the management company will have the right, subject to the documentation of the transaction, to use the amounts credited into such account, as from the date of such agreement. Creditors of the seller will not be able to claim any of the sums collected into this account, under any circumstances including the opening of insolvency proceedings against the seller.

### 5.7 Bank Accounts. Does France recognise escrow accounts? Can security be taken over a bank account located in France? If so, what is the typical method? Would courts in France recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in France?

Under French law, a security interest may be taken over a bank account. Pursuant to articles 2358 *et seq.* of the French Civil Code, the seller may grant a security interest on the balance of a bank account (*nantissement de compte bancaire*) in accordance with the principles applicable to pledges over receivables (*nantissement de créances*).

The French Monetary and Financial Code also provides for specific forms of pledge over bank accounts known as *garanties financières* which provide, in certain circumstances, a better protection in case of bankruptcy of the debtor.

The law applicable to charges (*sûretés réelles*) under French law is, as a matter of principle, the law of location (*lex rei sitae*) of the asset (either movable or immovable). Similarly, financial guarantees under Directive 2002/47/CE are governed by the law of the Member State in which the financial instruments account is located. Therefore, in case a French bank account is subject to a security interest, the law of such pledge shall be French law, according to the *lex rei sitae* and by analogy to the provisions on financial guarantees. French courts are generally reluctant to recognise foreign security interests over assets located in France. They set up a series of requirements based on the principle that charges (*sûretés réelles*) are enumerated to a limited



extent under French law (*numerus clausus*). Hence, the foreign security interest shall correspond to a type of security interest recognised in France and its validity and enforceability requirements shall be similar to those requested under French law.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

In case of a security over a bank account governed by articles 2538 *et seq.* of the French Civil Code, the scope of the pledge is the credit balance of the bank account on the date the security is enforced. As from the enforcement of the security over the bank account, such account will be blocked and the secured party will be able to control the cash flowing into the relevant account until the release of the pledge over the bank account i.e. until full repayment.

In the context of *garanties financières*, the beneficiary will be entitled, subject to the terms of the agreement and the way the *garantie financière* is structured to control all cash flowing to the relevant account as from enforcement and until the secured obligations are repaid in full.

In addition and although this is not considered as a security as such under French law, it must be remembered that, as seen in the answer to question 5.6, the French Securitisation Law provides for specially dedicated bank accounts that are set up in the books of the collection bank and that will allow the management company to control the cash flowing into the collection account, subject to the terms of the agreement.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

In the case of the French Civil Code regime (as described above), the owner of the bank account may have access to the funds standing to the credit of the bank account subject to the pledge, without affecting the security.

In the context of *garanties financières*, the right of the guarantor to use the money will depend on the type of financial guarantee chosen by the parties. The preferred route i.e. remittance of cash by the guarantor to the credit of a bank account owned by the beneficiary does not allow the guarantor to use the collateralised amount of cash, since the guarantor is not the owner of the bank account on which the sums are standing.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will France's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

The commencement of French insolvency proceedings (i.e.

safeguard, reorganisation or liquidation proceedings) against the seller after the sale of receivables should not prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the receivables, provided that the sale is performed under the French Dailly Law, the French SCF Law, the French SFH Law or the French Securitisation Law to a credit institution, a SCF, a SFH, a FCT, or a SDT. From an insolvency law point of view, the sale is valid and enforceable against third parties (including an insolvency official) as from the date of the sale document, and qualifies as a true sale by virtue of law.

In respect of the sale of future receivables (i.e. receivables that arise after the seller becomes subject to an insolvency proceeding), the sale of such receivables by way of a Dailly, SCF, SFH, FCT or SDT sale document (*acte de cession*) should not be affected by the commencement of French insolvency proceedings against the seller as such principle is clearly stated in the law. However, recent court decisions may be seen as challenging this principle, drawing a distinction between receivables which arise from a milestone agreement (*contrat à execution successive*) or another type of agreement, outright assignment or assignment by way of security and, possibly, notified debtors and other debtors.

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

The insolvency official could not prohibit the exercise of rights by the purchaser of the receivables by means of injunction, stay order or other action (but see question 6.1).

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in France for (a) transactions between unrelated parties, and (b) transactions between related parties?**

In the context of reorganisation or liquidation proceedings (but not safeguard proceedings), a sale of receivables may be challenged by the receiver during a so-called "suspect" period (*période suspecte*) of up to 18 months prior to the opening of insolvency proceedings if the insolvency official can establish that the sale was made for inadequate value, or if the purchaser was aware of the seller's insolvency at the time of the purchase.

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

Generally, the insolvency official of the seller cannot request the court to order consolidation of the assets and liabilities of the purchaser with those of the seller or its affiliates unless the court finds that there is abnormal commingling of assets between the purchaser and the seller (*confusion de patrimoines*) or the purchaser is considered to be a sham or a mere fiction (*fictivité*). In these circumstances, the insolvency proceedings would be extended to the purchaser and would affect its assets, in that the assets of the seller and that of the purchaser would be consolidated.

**6.5 Effect of Proceedings on Future Receivables.** If insolvency proceedings are commenced against the seller in France what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

See question 6.1.

**6.6 Effect of Limited Recourse Provisions.** If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?

Whether or not the debtor may be considered insolvent in such a situation depends on the definition and interpretation of the concept of *cessation des paiements* (cessation of payments) used by French courts to decide if insolvency proceedings must be opened against a debtor.

The concept of *cessation des paiements* is defined by article L.631-1 of the French Commercial Code as the impossibility of the debtor to pay its liabilities when due (*passif exigible*) out of its available assets (*actif disponible*). French law has limited the scope of the concept of *passif exigible*, which is clearly limited to *passif échû* (liabilities which have reached their maturity date or receivables which are accelerated). However, where the debtor can establish that the creditor has granted a moratorium on payment of the relevant debts and that consequently the debtor is able to pay its debts, such debtor will not be considered as insolvent.

In addition, it must be mentioned, that non-petition clauses are not given effect under French law (see question 7.4).

## 7 Special Rules

**7.1 Securitisation Law.** Is there a special securitisation law (and/or special provisions in other laws) in France establishing a legal framework for securitisation transactions? If so, what are the basics?

The French Securitisation Law dated 23 December 1988, as lastly amended by *Ordonnance* No 2009-15 dated 8 January 2009, codified in articles L.214-167-I to L.214-190 of the French Monetary and Financial Code, implemented a legal framework for securitisation transactions in France.

See the basics in question 7.2.

**7.2 Securitisation Entities.** Does France have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

The French Securitisation Law created the *fonds communs de titrisation* (literally, a 'common pool of securitisation', although a better translation would be 'mutual debt fund'). The FCT is a co-ownership vehicle whose sole purpose is the acquisition of debt receivables. The FCT does not have separate legal personality. It may consist of several ring-fenced 'compartments'.

The FCT must be constituted jointly by a management company and a custodian. The management company is either an investment management company governed by articles L.532-9 *et seq.* of the French Monetary and Financial Code or a management company of *fonds communs de créances* (common pool of receivables) governed by article L.214-175.I in the version before *Ordonnance* No 2008-556 dated 13 June 2008.

The custodian is a credit institution incorporated in the European Economic Area or any institution approved by the French government. The management company and the custodian play an important role in the creation and the life of the FCT, the former as manager of its business and the latter as custodian of the FCT's assets and as supervisor of the management company.

The French legal provisions on securitisation provides that the FCT is entitled to acquire all types of debts, including existing or future receivables, non-performing receivables or any type of debt instrument governed by French law or any foreign law. The law also provides for the possibility of multiple issues by the FCT of units or any type of debt instruments, including bonds, governed by French law or by any foreign law. Finally, the FCT is entitled to enter into synthetic transactions either as a protection buyer or protection provider, and is the only French entity qualifying as a bankruptcy-remote vehicle for rating purposes. From past experience, it seems that the use of a FCT is the ideal tool for international securitisation transactions (see question 4.1).

FCTs may also be used in order to securitise insurance risks.

French law recently introduced the possibility for a FCT to qualify as a *fonds de prêts à l'économie* (FPE), pursuant to article R.332-14-2 of the French Insurance Code. The FPE is designed to mainly target French insurance companies as investors, since they are benefiting from a privileged regulatory treatment for the securities issued by a FPE and subscribed by such French insurance companies.

As far as tax is concerned, the FCT is tax-exempt.

Securitisation vehicles can also be set-up under the form of a SDT. In this case, the SDT is a commercial company benefiting from the same rules as for a FCT but it is subject to tax under ordinary rules.

**7.3 Limited-Recourse Clause.** Will a court in France give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

The question as to whether contractual limitations on the *droit de gage général* (commonly referred as to "limited recourse clause") are valid has given rise to differing doctrinal views and is the subject of very little jurisprudence. However, it is now generally admitted that a court will give effect to a limited recourse clause provided that (i) the limited recourse clause has been freely and knowingly agreed to by the creditor for the benefit of its debtors (and has not been imposed on the creditor by the debtors), and (ii) is the fair consideration for the obligations set out in the agreement such as those pursuant to which the debtors agree to do or not to do certain specific things, or to allocate to the creditor certain cash flows in accordance with a specific priority of payment.

It is common practice to include in agreements relating to a securitisation transaction a provision whereby the parties acknowledge and agree that the assets of the FCT are limited to the receivables it acquires and the cash collected on its accounts.

Moreover, it is also common practice to provide that, past a certain date after the maturity date of the last receivable acquired by the FCT, the parties to the transaction agreement waive their rights to any residual amount the FCT might owe them (*abandon de créances*).

**7.4 Non-Petition Clause.** Will a court in France give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

The validity of a non-petition provision has been highly discussed under French law as such provision is part of other standard provisions contained in the legal documentation of securitisation transactions. However, it is generally admitted under French law that a court will not give effect to such provision.

**7.5 Priority of Payments "Waterfall".** Will a court in France give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

The French Securitisation Law (article L.214-169-I of the French Monetary and Financial Code) states that the constitutive documents of the securitisation vehicle may provide for a subordination of the rights of certain creditors to the rights of other creditors. The allocation rules of the cash received by the securitisation vehicle are binding upon the unitholders, the shareholders (as the case may be), the holders of debt instruments issued by the securitisation vehicle and any creditors that have agreed to such allocation rules and subordination rights. The French judge will therefore have to give effect to these contractual provisions, deriving from the French Securitisation Law. In the case of foreign law-governed documentation, the judge will give effect to foreign law-governed provisions, subject to the French public policy rules. (See the answer to question 2.3.)

**7.6 Independent Director.** Will a court in France give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Under French law, organisational documents and/or any other contract may prohibit directors to take certain specified actions without the vote or consultation of another director appointed as independent director. However, depending on the legal form of the company (e.g. *société par actions simplifiée*) and the title of the person acting on behalf of the company, such provisions may not be enforceable against third parties.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc.** Assuming that the purchaser does no other business in France, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in France? Does the answer to the preceding question change if the purchaser does business with other sellers in France?

Any purchaser other than a FCT or SDT must be licensed in France as a credit institution in order to purchase non-matured receivables on a regular basis for consideration.

The fact that the purchaser does business in France with other sellers has no impact on the above requirement which relates to the nature of the contemplated operation (i.e. the purchase of non-matured receivables).

**8.2 Servicing.** Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Servicing and collection activities for the benefit of third parties are also regulated activities in France unless the purchaser is a credit institution, a FCT, or a SDT. In practice, when the seller acts as servicer or collection agent of its own receivables for the account of the purchaser, it is not required to comply with French regulation applying to servicing activities. It should be noted that under the French Securitisation Law the transfer of servicing from the seller to any third party must be notified to the debtors.

**8.3 Data Protection.** Does France have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

French law regulates the transfer of personal data. The aim of such regulation is to protect the rights of individuals, including consumer debtors. However, it does not apply to debtors that are incorporated as enterprises.

The applicable regulation is known as the "*Loi Informatique et Liberté*" dated 6 January 1978 (as amended). Under such regulation, the transferor of personal data must, except under certain circumstances, inform each individual of any data transfer that directly identifies such individual or could allow his identification. The application of such regulation is placed under the control of the *Commission Nationale Informatique et Liberté (CNIL)*.

In practice, there have been a number of solutions implemented in order to accommodate the application of the relevant regulation within the context of securitisation transactions, such as transferring only partial information or codified information.

**8.4 Consumer Protection.** If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of France? Briefly, what is required?

The purchaser will not be required to comply with any additional

consumer protection law except as stated in question 8.2. Consumer protection law, such as enforcement rules against consumer debtors, will continue to apply to the extent that the seller acts as servicer.

---

**8.5 Currency Restrictions. Does France have laws restricting the exchange of France's currency for other currencies or the making of payments in France's currency to persons outside the country?**

---

Under French law, it is a general principle that international payments are free of any administrative or governmental control. However, recent anti-money laundering rules impose an obligation on credit institutions to declare any suspect payments or transactions.

## 9 Taxation

---

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in France? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?**

---

Since 1 March 2010, payments of interest and other income by debtors established or domiciled in France are not subject to any French withholding tax, unless they are made outside France in a non-cooperative State or territory (NCST) within the meaning of Article 238-0 A of the French Tax Code (FTC), in which case they are subject to the 75 per cent withholding tax set out under FTC, §125 A III, unless a tax treaty reduces or eliminates such withholding tax.

A jurisdiction is defined as a NCST if, cumulatively: (i) it is not a Member State of the European Union; (ii) it is under scrutiny by the OECD Global Forum on Transparency and Exchange of Information; and (iii) it has not entered into with France, or with twelve other jurisdictions, a treaty providing for the exchange of information in relation to tax matters.

The latest list of NCST was published by the French government on 17 January 2014 (with retrospective effect as from 1 January 2014) and includes the following countries: the British Virgin Islands, Brunei, Botswana, Guatemala, Marshall Islands, Montserrat, and Nauru and Niue.

The list is updated every year by the French government, with a view to including jurisdictions which would qualify as NCSTs pursuant to the criteria referred to above or which would, in practice, not be sufficiently cooperative with the French tax authorities (FTA). In any case, if a State or territory is added to the list on year N, the new rules will only have effect on payments to this State or territory on 1 January of year N+1. Jurisdictions which agree to exchange information in relation to tax matters with France, or which are removed from the aforementioned OECD list of jurisdictions under scrutiny, would be removed from the NTSC list with immediate effect.

Interest payments on debt instruments issued or entered into prior to 1 March 2010 or which are to be consolidated (*assimilables*) with debt instruments issued before 1 March 2010 continue to benefit from the exemption (where available) provided by FTC, §131 *quater*. (In particular, interest paid in respect of *obligations* or *titres de créances négociables*, or other debt securities considered by the FTA as falling into similar categories, are exempt from the

withholding tax set forth in FTC, §125 A III under FTC, §131 *quater*.)

The 75 per cent withholding tax does not apply if the debtor can prove that the “*main purpose and effect*” of the transactions from which the payments originate is not to “*locate*” income in a NCST. Pursuant to the official doctrine of the FTA (BOI-RPPM-RCM-30-10-20-50-20120912, ## 70 and 80), an issue of debt securities benefits from such exception without their issuer having to provide any proof of the purpose and effects of such issue if such debt instruments are:

- (i) offered by means of a public offer within the meaning of article L.411-1 of the French Monetary and Financial Code or pursuant to an equivalent offer in a state other than a NCST (i.e. any offer requiring the registration or submission of an offer document by or with a foreign securities market authority);
- (ii) admitted to trading on a French or foreign regulated market or multilateral securities trading system, provided that such market or system is not located in a NCST and the operation of such market is carried out by a market operator, an investment services provider, or a similar foreign entity, provided further that such market operator, investment services provider or entity is not located in a NCST; or
- (iii) admitted, at the time of their issue, to the clearing operations of a central depository or of a securities clearing, delivery and payments systems operator within the meaning of article L.561-2 of the French Monetary and Financial Code, or of one or more similar foreign depositories or operators, provided that such depository or operator is not located in a NCST.

---

**9.2 Seller Tax Accounting. Does France require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

---

No, it does not.

---

**9.3 Stamp Duty, etc. Does France impose stamp duty or other documentary taxes on sales of receivables?**

---

There is no transfer tax, stamp duty or other documentary tax on the assignment of receivables (unless the assignment is voluntarily registered with the FTA, in which case a nominal stamp duty of EUR 125 per registered document is payable).

---

**9.4 Value Added Taxes. Does France impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

---

The assignment of receivables should not attract VAT in France.

The servicing fee paid to a French seller qualifies for the VAT finance exemption, except as regards debt recovery services which are subject to French VAT.

---

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

---

No, it will not.

**9.6 Doing Business. Assuming that the purchaser conducts no other business in France, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in France?**

The purchaser would have a French corporate income tax liability if the place of effective management of the purchaser were in

France or the purchaser had a permanent establishment (*PE*) in France. In relation to securitisations, the question is whether the fact that the collection of receivables is carried out by the French seller might result in the French seller being deemed to act as a dependent agent of the purchaser and thus in creating a French *PE* of the purchaser. In order to reduce that risk, the seller should have limited authority to bind the purchaser, and the servicing agreement should be carefully drafted.



**Hervé Touraine**

Freshfields Bruckhaus Deringer LLP  
2 rue Paul Cézanne  
75008 Paris  
France

Tel: +33 1 44 56 44 67  
Fax: +33 1 44 56 44 00/01/02  
Email: [herve.touraine@freshfields.com](mailto:herve.touraine@freshfields.com)  
URL: [www.freshfields.com](http://www.freshfields.com)

Avocat à la Cour, Hervé Touraine joined Freshfields Bruckhaus Deringer in 1995 and became partner in 1998. His practice focuses on structured finance, securitisation, capital markets and banking. In the context of securitisation transactions, Hervé has been working closely since the introduction of securitisation in France, with various arrangers, originators, rating agencies, monoline insurers and regulatory authorities. Hervé has advised on numerous domestic and international transactions (including many firsts in France and Europe). Hervé has extensive experience in structuring and managing cross-border securitisations involving numerous countries. He is an active player in drafting French securitisation and structured finance legislation and regulations in France.



**Laureen Gauriot**

Freshfields Bruckhaus Deringer LLP  
2 rue Paul Cézanne  
75008 Paris  
France

Tel: +33 1 44 56 29 46  
Fax: +33 1 44 56 44 00/01/02  
Email: [laureen.gauriot@freshfields.com](mailto:laureen.gauriot@freshfields.com)  
URL: [www.freshfields.com](http://www.freshfields.com)

Avocat à la Cour, Laureen Gauriot joined Freshfields Bruckhaus Deringer LLP's Finance group in October 2009. She graduated from the University of Paris XII (postgraduate degree in Business Law), from the University of Paris II- Panthéon Assas (postgraduate DESS-DJCE Business Law), and from King's College (LL.M. in International Financial Law). Her practice focuses on structured finance, securitisation and debt capital markets. She has worked on several domestic and international securitisation programmes for major financial institutions and corporates.



**FRESHFIELDS BRUCKHAUS DERINGER**

Freshfields Bruckhaus Deringer is widely regarded as having one of the best international securitisation practices available.

Through its international network it handles a significant proportion of the largest and most complex transactions, including those with a large cross-border element, in both civil law and common law jurisdictions.

We award great importance to the quality of the advice we give to our clients. We strive to understand their legal, economic and commercial environment in order to anticipate their needs and assist in their strategic decision making process. We deliver creative, pragmatic advice adapted to our clients' circumstances.

The flexibility and resourcefulness of our lawyers enables our Practice to accompany our clients in their most varied projects, especially during the financial crisis where innovation and simplicity are key to success.

The Finance Group in Paris currently consists of 25 lawyers, including 5 Partners and 4 Counsels. Their biographies are available on our website.

# Germany

Dr. Werner Meier



Michael Kern



Cleary Gottlieb Steen & Hamilton LLP

## 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

Under German law, it is not necessary for the creation of an enforceable debt obligation of the obligor that a sale of goods or the provision of services be evidenced by a formal receivables contract. It is sufficient if the parties agree orally on the sale of goods or the provision of services, or if the respective agreement is deemed to exist due to the facts and circumstances, including as a result of the behaviour of the parties. Of course, in such cases it may, as a practical matter, be difficult to prove the scope of the sale or the services concerned, as well as the consideration payable therefor. An invoice alone, if not backed by a formal or informal receivables contract, would not be sufficient to create an enforceable debt obligation.

**1.2 Consumer Protections. Do Germany’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

There are no German laws that would specifically regulate permissible rates of interest on consumer credit, loans or other kinds of receivables. Under a general provision in the German Civil Code, however, a receivables contract that provides for a usurious rate of interest can be void. According to German case law, as a rule of thumb, the applicable limit in this regard is twice the market rate or, in periods of particularly high market rates, around 12 per cent *per annum* above the market rate. The application of the referenced code provision will, however, always be driven by the facts and circumstances.

If the obligor is in arrears (*Verzug*) in discharging the receivable of the seller, German statutory law provides that the receivable bears interest at the base interest rate (*Basiszinssatz*) published by Deutsche Bundesbank plus 5 per cent *per annum* or, if the obligor is not a consumer, 8 per cent *per annum*. An obligor would generally be in arrears if it does not make payment when due and: (i) the payment was due on a specified date; (ii) the obligor has,

after the payment became due, received a payment reminder (*Mahnung*); or (iii) the obligor has received an invoice and does not make payment within thirty days of the due date and the receipt of such invoice (provided that, if the obligor is a consumer, this consequence has been clearly pointed out to the obligor).

For loans to consumers (and transactions, such as hire-purchase transactions, that are closely linked to consumer loans), German law provides for special rules that are designed to protect consumer borrowers. In order to be enforceable in accordance with their terms, any such loan agreements have to contain certain information on the loan (which should help the consumer to assess his or her future payment obligations) and need to be in writing. In addition, the lender is obligated to explain the features of the loan. In the case of real estate loans, the lender also has to inform the consumer borrower of any possibility to assign the loan without the borrower’s consent. The borrower is entitled to rescind the loan agreement within two weeks from its execution. Furthermore, the lender is required to notify the borrower in advance of an interest reset and approaching maturity.

Borrowers may, in general, terminate loans as of the end of the period for which a fixed rate of interest was agreed if such period expires prior to the maturity of the loan and no new rate of interest is agreed. In any case, borrowers may terminate loans with six months’ prior notice as of the end of the tenth year following the disbursement of the loan. Loans with a floating rate of interest may be terminated with three months’ prior notice.

Other consumer protection laws become relevant in respect of contracts entered into at the place of abode of the obligor and contracts comprising standard business terms.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

Where the government or its agencies enter into receivables contracts for general commercial purposes, no special rules apply to the sale, assignment or collection of such receivables, except that any such assignment is valid, generally, even where there is a contractual prohibition on assignments (*see* question 4.4 below). Special assignment restrictions and notice requirements apply to tax reimbursement and similar claims. Tax authorities can enforce assessed taxes without the help of the courts. In securitisation transactions, due to enforceability concerns, public law receivables against government agencies are frequently considered ineligible.

## 2 Choice of Law - Receivables Contracts

### 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Germany that will determine the governing law of the contract?

In principle, under Regulation (EC) 593/2008 on the law applicable to contractual obligations (Rome I) (the “*Regulation*”), in the absence of any (explicit or implicit) choice of law by the parties to the receivables contract, the laws of the country to which such receivables contract has the closest link govern the receivables contract. In this context, the Regulation contains several presumptions which help identify what country that is. If the specific presumptions do not apply, the laws of the country apply where the contractual party that has to perform the characteristic obligations under the contract is located. The presumptions and this general rule do not apply if a contract is manifestly more closely connected with another country, in which case such country’s laws apply. Special rules apply to particular categories of contracts, namely consumer contracts, shipping contracts, insurance contracts and employment contracts.

### 2.2 Base Case. If the seller and the obligor are both resident in Germany, and the transactions giving rise to the receivables and the payment of the receivables take place in Germany, and the seller and the obligor choose the law of Germany to govern the receivables contract, is there any reason why a court in Germany would not give effect to their choice of law?

No. A German court would give effect to the parties’ choice of law.

### 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Germany but the obligor is not, or if the obligor is resident in Germany but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Germany give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

As a general rule, the Regulation permits the parties to a receivables contract to choose the law governing that contract. Such a choice of law can be express or implied. A choice of law provision can also be added or modified after the original contract was entered into. However, where a receivables contract is exclusively connected with one or more EU Member States and the parties have chosen the law of a non-EU Member State, German courts would apply such provisions of EU law (as implemented in Germany) which cannot be derogated from by agreement, irrespective of the choice of law. In addition, German courts may give effect to overriding mandatory provisions of the law of the country where the contractual obligations have to be performed. Finally, any contractual choice of law is subject to the German *ordre public*.

### 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Germany?

Yes, the CISG has been ratified and has been in effect in Germany since 1 January 1991.

## 3 Choice of Law - Receivables Purchase Agreement

### 3.1 Base Case. Does Germany’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Germany’s laws or foreign laws)?

As regards the relationship between the seller and the purchaser, German law (i.e., the Regulation) does not require the sale of receivables to be governed by the law governing the receivables. Accordingly, the seller and the purchaser may choose the law that shall apply to the sale, subject to the rules described in question 2.3 above. However, as regards (i) the receivables’ assignability, (ii) the relationship between the purchaser and the obligor, and (iii) the question whether the assignment can be invoked against the obligor, the law governing the receivables applies. Furthermore, the Regulation is silent, and there is no other express rule in German law, as to what law applies to the enforceability of the sale *vis-à-vis* third parties. While we would expect German courts in light of past practice to apply the law governing the receivables in this respect, some commentators have taken the view that the laws of the seller’s jurisdiction should govern the question whether a sale of receivables is effective *vis-à-vis* third parties.

### 3.2 Example 1: If (a) the seller and the obligor are located in Germany, (b) the receivable is governed by the law of Germany, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Germany to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Germany, will a court in Germany recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes, because under the rules described in question 3.1 above, German law would apply to the question whether the sale is effective against the seller, the obligor and other third parties.

### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Germany, will a court in Germany recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

As described in question 3.1 above, generally, neither the obligor’s nor the purchaser’s location is relevant for the question of what law applies to the effectiveness of sales of receivables. Accordingly, a German court would recognise the sale as being effective without regard to any requirements of the obligor’s country or the purchaser’s country (or both).

- 3.4 Example 3: If (a) the seller is located in Germany but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Germany recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Germany's own sale requirements?**

As described in question 3.1 above, a German court would generally apply the law selected by the parties as regards the relationship between the seller and the purchaser (subject to the rules described in question 2.3 above). Accordingly, a German court would recognise the sale as being effective as regards the relationship between the purchaser and the seller because the sale complies with the requirements of the law chosen by the parties to govern the receivables purchase contract. Furthermore, a German court would view the sale as being effective against the obligor because the sale complies with the laws governing the receivable. If a German court also applied, in light of past practice, the law governing the receivable to the question whether the sale is effective against third parties, there would be no need to comply with Germany's own sale requirements. If, however, the court applied the law of the seller's jurisdiction (*see* question 3.1 above) in this respect, it would consider the sale as being effective against the obligor only if the parties also complied with such requirements.

- 3.5 Example 4: If (a) the obligor is located in Germany but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Germany recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Germany's own sale requirements?**

Yes, because under the rules described in question 3.1 above, the law of the seller's country would apply to the question whether the sale is effective against the seller, the obligor and other third parties.

- 3.6 Example 5: If (a) the seller is located in Germany (irrespective of the obligor's location), (b) the receivable is governed by the law of Germany, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Germany recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Germany and any third party creditor or insolvency administrator of any such obligor)?**

As described in question 3.1 above, a German court would recognise the sale as being effective against the seller because a German court would apply (subject to the rules described in question 2.3 above) the law chosen by the parties with regard to the relationship between the purchaser and the seller and the sale complies with the requirements of such law, provided that the receivable is assignable pursuant to the law governing it (i.e., German law). As regards the relationship between the purchaser and the obligor as well as third parties, a

German court would apply German law (which is the law of the seller's location as well as the law governing the receivable) to the question whether the sale is effective.

## 4 Asset Sales

- 4.1 Sale Methods Generally. In Germany what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

Although not legally required, for evidentiary purposes, receivables are generally sold and assigned under a written sale and assignment agreements entered into between the seller and the purchaser. The customary terminology for the transfer of a receivable under German law is an "assignment" (*Abtretung*), while a "sale" (*Verkauf*) describes the contractual undertaking to assign. However, elsewhere in this chapter, the term "sale", in line with the definition of such term above, is used to describe a transfer.

- 4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

Under German law, generally, the only requirement for an effective sale of receivables is the existence of a corresponding assignment agreement between the seller and the purchaser. Giving notice of the assignment to the obligor is not required for the effectiveness of the sale. However, failure to give notice to the obligor results in the obligor retaining certain defences as described in question 4.4 below. Under German law, generally, there is no good faith acquisition of receivables.

- 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

In Germany, debt certificates (*Schuldscheine*) are frequently used instruments that are similar to promissory notes in other jurisdictions. Debt certificates, which evidence loan obligations, are not securities. No additional requirements apply to the assignment of debt certificates, although in practice the purchaser requires the seller to hand these over in connection with an assignment of the related loan.

Mortgage loans in Germany can take several forms. Liens on German real property can be granted in the form of an accessory mortgage (*Hypothek*) or a non-accessory land charge (*Grundschild*). Both can be either in certificated or non-certificated form. A mortgage is accessory in that it cannot be transferred without the receivable that it secures, and that it is automatically transferred if such receivable is transferred. The assignment of a loan that is secured by a mortgage requires a written assignment of the loan and: (i) in the case of a certificated mortgage, delivery of the mortgage certificate; or (ii) in the case of a non-certificated mortgage, registration of the transfer with the competent land register. A loan secured by a land charge can be assigned without the land charge, by way of a simple agreement between the seller and the purchaser. If the land charge is to be transferred as well, such transfer has to be by written assignment of the land charge and delivery of the certificate or registration of the transfer, as applicable. In addition, according to recent case law the



purchaser has to assume the seller's obligations under the security purpose agreement setting forth the conditions under which the land charge may be enforced.

Transferring non-certificated mortgages and land charges (which make up the vast majority of mortgages and land charges in Germany) can, depending upon the values involved, trigger significant costs in connection with the required registration with the land register. In many cases, sellers express an interest in avoiding registration of the transfer in order to avoid having the obligor obtain knowledge of the assignment. For this purpose, the parties frequently agree that the seller shall hold the land charge as trustee for the purchaser. (This is not possible in the case of a mortgage.) However, it is unclear under German law whether such a trust relationship would be recognised in the insolvency of the seller, i.e., whether the purchaser would be entitled to require the seller's insolvency official to transfer the land charge.

In response to this, the German Banking Act (*Kreditwesengesetz*) was amended in September 2005 to provide for, among other things, so-called "refinancing registers" (*Refinanzierungsregister*) to be maintained by banks in respect of receivables, including mortgages or land charges securing such receivables that such bank or a third party owns but is obligated to transfer to a securitisation vehicle. Effectively, without a perfected sale being effected at the outset of the transaction, such registration provides the purchaser with the same right to segregate the assets concerned from the seller's insolvency estate (thereby addressing the issues described above) as would apply if a perfected sale had occurred.

In the case of an assignment of consumer loans, the seller must notify the consumer of the assignment and the details of the purchaser without undue delay, unless the seller and the purchaser agree that the seller shall exclusively continue dealing with the consumer obligor. Also, an advance consent of the obligor (in particular a consumer) contained in standard business terms to an assumption of the entire loan contract by a purchaser is no longer effective, unless the purchaser is identified in the standard business terms or the obligor is given the right to terminate the loan in case the loan contract is transferred.

Additional requirements relating to the sale of debt securities under German law depend upon the type of securities involved. The transfer of bearer securities requires an agreement between the seller and the purchaser to transfer ownership and the delivery of the securities to the purchaser. Registered securities are transferred by way of assignment of the rights that they evidence. Instruments made out to order are transferred by way of agreement between the seller and the purchaser to transfer ownership, endorsement and delivery of the instrument to the purchaser. Where debt securities are certificated in global form and deposited with a clearing system, delivery of the securities is evidenced by way of book-entry.

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

In principle, under German law, giving notice to the obligor is not required for an effective sale and assignment of a receivable, unless

required by the receivables contract. The purchaser is generally entitled to enforce the receivable directly against the obligor (providing required evidence of the assignment), whether or not the obligor was previously notified of the assignment. However, the obligor may generally invoke against the purchaser all defences that it had against the seller at the time of the sale (see below). If the sold receivable is a consumer loan, the seller generally must notify the consumer of the assignment and the details of the purchaser. The violation of the obligation to notify a consumer obligor does not affect the effectiveness of the sale and assignment of the receivable, but may entitle the consumer obligor to claim damages.

Unless the obligor has been notified or has otherwise obtained knowledge of the assignment, it may validly discharge its obligation by making payment to the seller, and the purchaser is bound by any amendment to the receivables contract agreed by the seller and the obligor. The same applies if the seller and the obligor enter into any other transaction relating to the receivable, such as a waiver of the receivable by the seller or a deferral of payments.

In addition, the obligor continues to be able to discharge its obligation under the assigned receivable by offsetting it against a payable of the seller unless (i) the obligor knew of the assignment when it acquired the payable, or (ii) the payable becomes due only after the obligor has obtained knowledge of the assignment and after the assigned receivable has become due. In other words, even if the obligor has obtained knowledge of the assignment, it may continue to offset the assigned receivable against a payable of the seller if (i) it acquired the payable before it obtained such knowledge, or (ii) the payable has become due before the receivable becomes due.

Accordingly, as described above, notification of the obligor is not required for an effective sale of a receivable under German law, but giving notice of the assignment to the obligor is beneficial in order to cut off certain defences of the obligor.

As a general rule, a receivable that is governed by German law can be freely sold and assigned without the obligor's consent if the underlying agreement does not contain any prohibition on assignments. A prohibition on assignments would usually be explicit, but can also be implied in a receivables contract. Until 2007, it has been disputed among German courts and commentators whether the assignment of a receivable in violation of German data protection laws or contractual general bank secrecy obligations should result in an implied prohibition on assignments. However, a decision of the German Supreme Court settled the issue in 2007 such that generally neither contractual general bank secrecy obligations nor German data protection laws result in implied prohibitions on assignments. It should be noted that the German Supreme Court confirmed in a decision rendered in October 2013 that an assignment of receivables involving the transfer of data whose confidentiality is protected by German criminal law (e.g., in respect of a doctor's patient data) is considered void unless the obligor has validly consented to the assignment.

Where a receivables contract contains a prohibition on assignments, the seller can still undertake to assign the receivable, but it cannot effect a valid assignment *in rem*. The seller is liable for any damages incurred by the obligor in connection with an assignment that failed on this basis.

As an exception to the foregoing rule, a seller can validly assign a receivable (with the exception of loan claims of credit institutions) in spite of a contractual prohibition on assignments where both the seller and the obligor are corporate entities, partnerships or individual merchants and the receivables contract constitutes a commercial transaction, or where the obligor is a government agency. However, it is not fully clear whether any such assignment

constitutes a breach of contract that can result in liability for damages or for the payment of any contractual penalty. In any event, in such a case the obligor can still discharge the receivable by making a payment to the seller (or by way of set-off), even where the obligor has been notified of the assignment. The resulting risks, which can be eliminated only by obtaining the obligor's consent, generally lead rating agencies to conclude that the highest rating categories cannot be applied where the effectiveness of the assignment is based upon this exception.

**4.5 Notice Mechanics.** *If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?*

As described in question 4.4 above, under German law, generally, the obligor need not be notified of the assignment to make the assignment effective, unless required by the receivables contract. However, notification is required to cut off certain defences of the obligor. No specific formal requirements apply to such notification. If a receivables contract requires notification, the notice must comply with the applicable contractual requirements. Furthermore, any such notice that is contractually required must be delivered before insolvency proceedings against the seller are commenced, because the assignment would not be effective without such notice. In contrast, even where a contractual notice requirement exists, it is possible to deliver the notice after insolvency proceedings against the obligor have commenced. Where a notice of assignment is specifically required under statutory law, the notice must comply with the applicable statutory requirements, e.g., be given in writing or contain certain information. Generally, if more than one receivable or future receivables are assigned, the assignment notice may be given for all receivables concerned.

**4.6 Restrictions on Assignment - General Interpretation.** *Will a restriction in a receivables contract to the effect that “None of the [seller’s] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]” be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says “This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]” (i.e., the restriction does not refer to rights or obligations)?*

A German court would be likely to interpret any of the restrictions above as prohibiting the assignment of receivables by the seller to the purchaser.

**4.7 Restrictions on Assignment; Liability to Obligor.** *If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Germany? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Germany recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?*

As described in question 4.4 above, parties other than, generally, merchants in respect of commercial transactions, can enter into binding prohibitions on assignments. Prohibitions to sell receivables (i.e., an undertaking not to enter into a receivables purchase agreement) would also be enforceable, but are not common because they do not prevent the assignment from being effective. If a seller sells a receivable in violation of a prohibition to sell or assign the receivable, it would be liable, generally, to the obligor for any financial damages incurred. Such liability for breach of contract is not fully clear in respect of commercial transactions among merchants and receivables against government agencies.

**4.8 Identification.** *Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?*

It is not necessary to specifically identify each of the receivables to be sold in order to provide for an effective sale and assignment of German law-governed receivables. It is sufficient if the receivables are identifiable, e.g., by reference to the initial letters of the obligor names, or if all of the seller's receivables (or all of its receivables other than receivables owing by one or more specifically identified obligors) are sold.

**4.9 Respect for Intent of Parties; Economic Effects on Sale.** *If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?*

A German court would not automatically respect the parties' denomination of their transaction as a sale, but also take into account the economic characteristics of the transaction. Furthermore, the economic characteristics have no bearing under German law as to whether the sale is being "perfected". However, such characteristics could be relevant for determining whether the sold receivables no longer form part of the seller's insolvency estate, or whether the transaction must be re-characterised as a

secured loan. Given that there is no case law on point and limited other guidance in published form in this respect, the exact circumstances in which a purported sale must be re-characterised as a secured loan are not fully clear.

The general view in the market is as follows: any true sale of receivables requires an effective assignment of legal ownership as described in question 4.2 above. In connection with any such assignment, the mere retention by the seller of the risk that the receivables exist and are legal, valid, binding and enforceable does not result in the true sale character of the transaction being jeopardised, and neither does the continued servicing of the receivables by the seller. The possible re-characterisation of the transaction rests, in particular, on the seller's retaining an excessive portion of the credit risk from the receivables sold, including through representations and warranties, repurchase obligations/automatic re-assignments, variable purchase prices, liquidity/credit enhancement provided by, or on behalf of, the seller, or the acquisition by the seller of a first loss *tranche* of the securities issued. The seller may retain some portion of the credit risk in line with historical default rates and taking into account enforcement costs.

Where the sale of receivables is re-characterised as a secured loan for insolvency law purposes, upon the opening of a German insolvency proceeding with respect to the seller, the seller's insolvency official and not the purchaser is entitled to collect the receivables. In addition, the insolvency official is entitled to retain from the collection proceeds a flat fee (haircut) of, generally, 9 per cent for the benefit of the insolvency estate. The amount of this fee may be adjusted where the actual enforcement costs are significantly higher or lower. A 4 per cent fee applies where the insolvency official permits the purchaser to collect the receivables. Upon a collection by the insolvency official, the collection proceeds (after deduction of these fees) are to be transferred to the purchaser. As a practical matter, secured creditors frequently enter into agreements with insolvency officials providing for higher haircuts.

---

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

---

Yes. However, as a technical matter, in factoring or securitisation transactions involving continuous or periodic sales and transfers of receivables, the seller and the purchaser generally enter into a framework agreement that governs the terms and conditions for each future sale and transfer of receivables. The actual sale and transfer in respect of individual receivables is then evidenced (in the case of continuous sales) or effected (in the case of periodic sales) on the basis of an exchange of data on the transferred receivables by which the latter are identified. However, such arrangements would not prevail in an insolvency of the seller for sales not consummated prior to the insolvency. See also question 6.5.

---

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?**

---

Under German law, it is possible to sell and assign receivables arising in the future, provided that such receivables are sufficiently

identified (or at least identifiable, *see* question 4.8 above). German law does not require any specific sale structure for the sale of future receivables being valid and enforceable beyond the requirements applicable to receivable sales generally. In principle, the sale of future receivables requires the existence of a corresponding assignment agreement between the seller and the purchaser (*see* question 4.2 above). The purchaser then obtains ownership of such receivables at the time when they arise, unless at such time other prerequisites of a valid assignment have ceased to exist, in which case the assignment fails. The latter applies, in particular, where an insolvency proceeding has been opened with respect to the seller prior to the receivable coming into existence because in such a case the seller is no longer able to dispose of its assets. It should be noted that, in certain circumstances, it is difficult to determine whether a receivable is, in fact, a "future" receivable to which these rules apply (such as a claim for future rental payments) or an existing receivable that is not yet due (such as the repayment claim under a loan agreement). See also question 6.5.

---

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

---

See question 4.3 above, in respect of transferring collateral of the type of instruments described therein. Related security consisting of receivables assigned by way of security assignment (*Sicherungsabtretung*) as well as guarantees (*Garantien*) is transferred by way of assignment, requiring an agreement between the seller and the purchaser to assign the relevant security. Insurance claims are also assigned, usually requiring notification to, and sometimes the prior consent of, the insurer. If the collateral comprises security over inventory and other movable assets in the form of a security transfer (*Sicherungsübereignung*), the purchaser needs to obtain (indirect) possession of the inventory concerned. If the sold receivable is secured by a pledge (*Pfandrecht*) or surety (*Bürgschaft*), no additional arrangements are necessary to transfer such collateral.

See also question 5.3 below.

---

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

---

See question 4.4 above with regard to how an assignment affects the set-off rights of the obligor. Beyond the statutory protections of the obligor's set-off rights described in question 4.4, the obligor would not be entitled to claim damages from the seller or the purchaser if its set-off rights terminate as a consequence of the assignment.

## 5 Security Issues

**5.1 Back-up Security.** Is it customary in Germany to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

No, this is not customary.

**5.2 Seller Security.** If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Germany, and for such security interest to be perfected?

This is not applicable in Germany (*see* question 5.1 above).

**5.3 Purchaser Security.** If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Germany to grant and perfect a security interest in purchased receivables governed by the laws of Germany and the related security?

Under German law, if the purchaser wants to grant security over all of its assets, it must individually charge such assets in accordance with applicable law, i.e., German law does not know the concept of a floating charge over all assets of the chargor. Generally, a German law security interest in a receivable or related security as well as other assets of the purchaser can be granted in the form of a formal pledge or a security assignment.

To become effective, a formal pledge of a receivable (including guarantees) requires the execution of a pledge agreement and notification of the obligor. A security assignment, which results in the transfer of legal ownership of the receivables concerned, subject to the assignee’s undertaking to foreclose only upon a default and to re-assign the receivables to the assignor upon the performance in full of the secured obligations, becomes effective on the basis of the same requirements as described above in respect of assignments of receivables generally. Accordingly, a security assignment generally does not require notification of the obligor. (However, failure to notify results in the obligor retaining set-off rights and other defences as described in question 4.4 above.) Due to the fact that assignors frequently seek to avoid such notification, security assignments are far more common than formal pledges of receivables. Exceptions to this rule apply where the notification of the obligor is not an issue, including in respect of inter-company receivables and bank accounts. There have been a few German securitisation transactions that have relied on pledges of receivables, but this continues to be a very uncommon form of security in Germany.

Security over inventory and other movable assets is usually granted in the form of a security transfer because a formal pledge would require the pledgee to obtain actual possession of the assets, whereas indirect possession is sufficient for a security transfer. For security over the types of instruments described in question 4.3 please *see* question 4.3. The additional requirements described therein generally also apply to the grant of security over such types of instruments.

*See* also question 4.12 above.

**5.4 Recognition.** If the purchaser grants a security interest in receivables governed by the laws of Germany, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Germany or must additional steps be taken in Germany?

The conflict of laws rules described in question 3.1 above in respect of assignments of receivables generally also apply to the grant of security interests, whether in the form of a formal pledge or a security assignment. Accordingly, as between the purchaser and the secured party, the security interest would be considered valid and perfected if the requirements of the law chosen to govern the security agreement were met, provided that the receivables are assignable pursuant to the law governing them (i.e., German law). Whether the security interest is valid and perfected with respect to the obligor depends on the law governing the receivables. Where the receivables are governed by the laws of Germany, the purchaser and the secured party need to take such additional steps, if any, as German law might require to validly grant and perfect the security interest *vis-à-vis* the obligor. The same applies in respect of the question whether the security is valid and perfected *vis-à-vis* third parties if a German court in that respect applied the law governing the receivables (and not the laws of the purchaser’s country, *see* question 3.1 above).

**5.5 Additional Formalities.** What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Under German law, security over insurance policies, promissory notes, mortgage loans, consumer loans and marketable debt securities can also be granted in the form of a formal pledge or by way of security assignment. (In the case of debt securities, the most common form of security is a formal pledge.) As a general matter, the additional requirements described in question 4.3 above also apply to the grant of security over these types of instruments. Security over insurance policies generally requires notification of the insurance company to be effective.

**5.6 Trusts.** Does Germany recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

German law concepts of fiduciary relationships or trusts are in many respects different from Anglo-American trust concepts. In particular, solely agreeing on a trust over an asset such as collections of receivables or bank accounts would not suffice to separate such collections or bank accounts from the seller’s estate and would not be upheld in an insolvency of the seller. Neither would an economic or equitable interest of the purchaser in an asset, as such, be sufficient to so segregate assets from the estate of the seller. (Under certain circumstances, a trust over non-German assets might be recognised by German courts and have the effect of segregating the trust assets, but this depends on the law governing the trust, the effects of such law, and whether such effects can be reconciled with German law concepts.)

In order to segregate collections from the estate of the seller, several structure alternatives exist. The safest way is to notify the obligors of the assignment and collect the receivables in an account of the purchaser. Alternatively, because the parties sometimes do not wish to notify the obligors of the assignment or if the notification is too cumbersome, the seller could continue to collect the receivables in

one or more accounts set up specifically for such purpose. Such accounts could be either pledged to the purchaser or established as escrow accounts which are, generally, recognised under German law. (Please note that the preference periods described in question 6.3 below might apply to the collections or disbursements thereof to the purchaser, unless such periods had already lapsed with respect to the acquisition of the collected receivable.)

Where it is not feasible to collect the receivables in a special account (whether pledged or in the form of an escrow account), the seller could pledge its “general” collection account to the purchaser, but this would in most cases not offer sufficient protection to the purchaser in respect of collections received prior to the opening of an insolvency proceeding. Also, such pledge might conflict with prior-ranking standard pledges of the account bank (which are customary in Germany). In such case, the purchaser would have to rely on the (automatic) termination of the seller’s entitlement to collect the receivable upon certain triggers and a swift redirection of the collections to minimise losses, usually coupled with frequent sweeps from the general account.

**5.7 Bank Accounts. Does Germany recognise escrow accounts? Can security be taken over a bank account located in Germany? If so, what is the typical method? Would courts in Germany recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Germany?**

As regards the recognition of escrow accounts, *see* question 5.6 above. Security over bank accounts located in Germany customarily takes the form of a formal pledge (*see* question 5.3). Taking foreign law security over bank accounts located in Germany is not customary, and there is a substantial risk that German courts would not recognise such security, in particular if the requirements of a formal pledge (including notification of the account bank) were not met.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

Assuming that the secured party enforces its German law security in the form of a pledge over a bank account at a time when insolvency proceedings have been commenced against the owner of the account, the secured party would not control any cash flowing into the bank account from enforcement forward. Rather, the secured party would be able, generally, to realise, in accordance with German law, its pledge over any amounts standing to the credit of the account at the time the insolvency proceedings were commenced (subject, in particular, to any rights of the insolvency official to challenge the security). If no insolvency proceedings have been commenced at the time of enforcement, the security arrangements can provide for the “control” of the secured party over all cash flowing into the bank account until repayment of the secured party in full, subject to corresponding arrangements with the account bank. *See* also question 5.6 above.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Yes, the parties can agree that the owner of the account shall have

access to the funds in the account prior to enforcement, which would not affect the security. Of course, any funds withdrawn from the account would no longer be available as security.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Germany’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

Before rendering a decision on whether or not to open a formal insolvency proceeding and to appoint an insolvency official, German insolvency courts frequently appoint a so-called “preliminary insolvency official” for the time period (generally one to three months – a so-called “preliminary insolvency proceeding”) during which they assess whether the insolvent company’s assets cover the costs of the insolvency proceeding. As a general matter, there is no stay of action on the purchaser’s right to collect, transfer and otherwise exercise ownership rights over receivables that were sold to it, neither before nor after the opening of an insolvency proceeding. Amendments to the German Insolvency Code that took effect on 1 March 2012 did not result in any changes in this regard. German insolvency courts, however, may prohibit persons owning assets not belonging to the insolvency estate (such as purchasers of receivables in true sale transactions) or holding security based on a security assignment over receivables from collecting or otherwise exercising their rights over the receivables during the preliminary insolvency proceeding. After the opening of an insolvency proceeding with respect to the seller, the purchaser would be entitled to collect the receivables only if the transaction constituted a true sale. Where the transaction is re-characterised as a secured loan, the assignment *in rem* of the receivables is regarded as a security assignment, which results in the insolvency official, rather than the purchaser, being entitled to collect the receivables concerned (and to deduct a haircut from the collection proceeds, all as described in question 4.9 above). *See* also question 6.2 below.

**6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?**

As described in question 6.1 above, German insolvency courts may prohibit persons owning assets not belonging to the insolvency estate (such as purchasers of receivables in true sale transactions) or holding security based on a security assignment over receivables from collecting or otherwise exercising their rights over the receivables during the preliminary insolvency proceeding. In addition, insolvency courts have the right to issue an order permitting a preliminary insolvency official to collect receivables that were assigned by way of security.

Upon the opening of an insolvency proceeding with respect to the seller, no injunctions, stay orders or similar court orders may be issued where there was a true sale, and there is no need for any such orders (because the insolvency official in any event has the

exclusive right to collect) where the transaction is re-characterised as a secured loan. However, as a practical matter, where the insolvency official seeks to determine whether the transaction constituted a true sale or has to be re-characterised as a secured loan and meanwhile prevent the purchaser from collecting the receivables, the insolvency official will simply notify the obligors accordingly. This generally has the effect that obligors cease making payments.

---

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Germany for (a) transactions between unrelated parties, and (b) transactions between related parties?**

---

Upon the opening of an insolvency proceeding in Germany, the insolvency official is entitled to rescind acts of the seller (including assignments of receivables) that prejudice third party creditors, provided that certain additional requirements are met. These requirements are set out in statutory rules. German insolvency courts do not have the same discretion in this respect that insolvency courts have in other jurisdictions. Preference periods range from one month to ten years prior to the filing of the application for the opening of the insolvency proceeding.

In particular, the insolvency official has the right to challenge acts that granted a creditor collateral or satisfaction if the act was performed (i) during the last three months prior to the filing of the application for the opening of an insolvency proceeding, provided that at such time the debtor was unable to pay its debts as they became due and the creditor knew of such inability, or (ii) after such filing, provided that at such time the creditor knew of the debtor’s inability to pay its debts or the filing.

The insolvency official can also challenge acts that granted a creditor collateral or satisfaction to which such creditor was not entitled – or not in such a way or not at such time – if the act was performed (i) during the last month prior to the filing of the application for the opening of an insolvency proceeding or after such filing, (ii) during the second or third month prior to the filing of the application and the debtor was illiquid at such time, or (iii) during the second or third month prior to the filing of the application and the creditor knew at the time such act was performed that such act was detrimental to the debtor’s third party creditors.

Furthermore, the insolvency official has the right to challenge acts performed with the intention – as known to the creditor – to prejudice the debtor’s third party creditors if the act was performed within ten years prior to the filing of the application for the opening of an insolvency proceeding, or after such filing.

Finally, the German Insolvency Code contains a number of presumptions that make it easier for an insolvency official to challenge transactions between the debtor and its related parties. E.g., the insolvency official may challenge any transaction between the debtor and a related party if the transaction was (i) entered into for consideration during the two years preceding the filing of the application to open an insolvency proceeding, (ii) directly detrimental to the debtor’s third party creditors, and (iii) performed by the debtor with the intention to prejudice the debtor’s third party creditors, unless the related party can prove that it did not know of such intention.

Where the assignment of receivables constitutes a so-called “cash transaction” (*Bargeschäft*), the insolvency official is entitled to rescind the transaction only if it can be shown: (i) that the assignment was effected with an intention to prejudice creditors and the purchaser knew of such intention; or (ii) that the purchaser was not entitled to the receivables assigned. An assignment of receivables generally constitutes a “cash transaction” if the seller, at or about the same time as the assignment was effected, received adequate consideration. In this respect, depending on the type of receivables involved, an assignment may qualify as a “cash transaction” even where the purchase price paid reflects some discount from the nominal value of the assigned receivables. A large discount, a significant time lag between assignment and payment of the consideration, or a deferred purchase price arrangement, however, disqualify the transaction as a “cash transaction”.

---

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

---

German insolvency law does not contemplate the substantive consolidation of assets and liabilities of sellers and purchasers or their affiliates. Under general corporate law principles, there may be liability under piercing the corporate veil principles, but this does not result in any consolidation of assets and liabilities. In January 2014, the German Federal Government (*Bundesregierung*) issued a draft Bill to Facilitate the Handling of Group Insolvencies (*Entwurf eines Gesetzes zur Erleichterung der Bewältigung von Konzerninsolvenzen*) which would, if enacted as drafted, introduce special rules relating to the insolvency of group companies. These new rules would provide for increased cooperation among the parties in separate insolvency proceedings in respect of various group companies, but there would continue to be no substantive consolidation of assets and liabilities.

---

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Germany, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

---

German insolvency law gives an insolvency official the right to elect whether to perform or reject performance of executory contracts, i.e., contracts that have not been fully performed by at least one party. The application of this general rule affects future sales of receivables as well as mutually unperformed contracts underlying the (existing) receivables sold and the assignment of receivables that have not yet come into existence (i.e., future receivables). Where the insolvency official’s election right does not apply in respect of a contract underlying receivables, the contract concerned continues to bind the insolvency estate and the counterparty, but as explained below this does not always result in the enforceability of the sale and assignment of resulting receivables.

The receivables purchase agreement itself may be subject to the insolvency official’s election right if the agreement has not been fully performed by at least one party, in particular if it addresses future sales. If properly drafted, however, receivables purchase agreements pertaining to term deals are generally not subject to the election right because the seller (by assigning the receivables) has

fully performed its relevant obligations. In the case of a receivables purchase agreement in a revolving securitisation transaction which provides for a series of sales under a single master agreement, any election by the insolvency official to reject performance may also pertain to sales that were consummated in the past. To avoid this risk, each sale under the master agreement must be structured as an independent transaction.

In the case of mutually unperformed contracts underlying the receivables sold, where the insolvency official has an election right and elects performance, any future payments by the obligors are due to the insolvency estate, not to the purchaser. Where the insolvency official elects to reject performance, the receivables do not become due at all. Consequently, unless the cash flows required to service the asset-backed securities are otherwise ensured, a successful securitisation generally requires that the insolvency official's election right does not apply to the underlying receivables contracts. In addition, an assignment of "future receivables" that come into existence after the opening of the insolvency proceeding (as opposed to the assignment of previously existing receivables that become due after the opening of the insolvency proceeding) is not enforceable.

- Upon the insolvency of the seller/lessor, leases and leasing contracts pertaining to movables are not subject to the insolvency official's election right if the acquisition of the leased objects was financed by a third party and that third party has obtained security in the form of a security transfer of the leased objects. (Legal uncertainty exists in this regard where the lessor is not identical to the owner of the leased objects, which is not uncommon in the German leasing market.) It is a question of the applicable facts and circumstances (i.e., in particular the terms of the applicable lease or leasing contract) whether the receivables under such contracts are, for German insolvency law purposes, "future receivables". In general, instalments due under so-called "financial leasing" contracts are considered not to constitute "future receivables", but to come into existence upon the conclusion of the leasing agreement and to become due from time to time.
- Leases pertaining to real estate are not subject to the insolvency official's election right but may be terminated by the insolvency official (subject to statutory notice periods) irrespective of the agreed term of the lease. Furthermore, lease receivables under real estate leases constitute "future receivables" and cannot be validly assigned with effect for the seller's/lessor's insolvency estate to the extent that they pertain to the period after the month in which the insolvency proceeding is opened (or, where the opening date is later than the 15th day of a month, the following month). Nevertheless, any such lease receivables can be (and customarily are) covered by a mortgage or land charge over the relevant real estate that can be enforced by the mortgagee in the seller's/lessor's insolvency.

By contrast, as regards the securitisation of fully disbursed bank loans, the insolvency official's election right does not apply, given that the relevant loan agreements no longer constitute executory contracts. This was clarified by a legislative amendment in 2007. Also, receivables becoming payable from time to time under a bank loan do not constitute "future receivables".

#### **6.6 Effect of Limited-Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

In the case of German SPE debtors (which are generally in the form of limited liability companies (*GmbHs*)), the debtor's management

would be under a statutory obligation to file for the opening of an insolvency proceeding where the debtor is either unable to pay its debts as they come due (i.e., illiquid) or over-indebted. If the parties have validly agreed to limit the other parties' recourse to the debtor's assets (see question 7.4 below), such agreement would prevent the debtor from becoming illiquid because its respective payment obligations would not come due. However, the debtor could still become illiquid if it does not have sufficient funds to discharge any of its obligations that are not subject to a limited-recourse provision. Likewise, if the limited-recourse provision provides for the conditional cancellation of the debtor's obligations that are not covered by the debtor's assets, such provision should prevent the debtor from becoming over-indebted. This result would not apply, however, in the case of a mere subordination of the relevant debt. Note that such a conditional cancellation (or subordination) of debt may have adverse tax implications for the debtor.

## **7 Special Rules**

### **7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Germany establishing a legal framework for securitisation transactions? If so, what are the basics?**

Germany has no laws containing a comprehensive set of rules applicable to securitisation transactions. However, certain typical aspects of securitisations are addressed in special statutes. In particular, under European banking laws that took effect on 1 January 2014, special rules apply to credit institutions and investment firms investing in, sponsoring or originating securitisation transactions. Most importantly, such institutions are prohibited from investing in securitisation transactions where the originator does not retain, on an ongoing basis, a net economic interest in the transaction of at least 5 per cent. Moreover, institutions investing in securitisation transactions must have a comprehensive and thorough understanding of the positions (and their underlying assets) they are investing in, and establish formal procedures in order to ensure such understanding and monitor the positions they have invested in. Similarly, restrictions on investments in securitisation transactions by insurance companies and pension funds are expected to be enacted. Although the rules are aimed at institutions, they indirectly affect other originators as well because such originators need to structure their securitisation transactions accordingly (by retention of an economic interest as well as reporting obligations) in order to allow institutions to invest in their securitisation transactions.

### **7.2 Securitisation Entities. Does Germany have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

Germany does not have any such laws. It should be noted that, in the past, no German entities were used as purchaser vehicles in securitisation transactions. This has mainly been due to the trade tax issue described in question 9.6 below. Following the introduction, in 2003, of a trade tax exemption for certain purchaser vehicles in bank loan securitisation transactions, there have been a number of transactions involving German purchaser vehicles, including transactions under the German True Sale Initiative.

**7.3 Limited-Recourse Clause.** Will a court in Germany give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

See question 7.4 below.

**7.4 Non-Petition Clause.** Will a court in Germany give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

The predominant view is that such limited-recourse and non-petition clauses are generally valid and enforceable under German law, and German courts will generally give effect to such arrangements independently of the governing law, provided that the parties have validly chosen such law in accordance with the rules described in question 2.3 above. Where the governing law is German law, such clauses might not be valid and enforceable to the extent that the relevant underlying claim is based upon the purchaser's wilful misconduct or gross negligence. See, however, question 7.6 below regarding the obligation of the management of certain types of companies organised under German law to file for insolvency upon illiquidity or over-indebtedness.

**7.5 Priority of Payments "Waterfall".** Will a court in Germany give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Creditors may validly agree on "waterfall" or "priority of payments" arrangements among themselves or with their debtor, and German courts generally will give effect to such arrangements independently of the governing law, provided that the parties have validly chosen such law in accordance with the rules described in question 2.3 above. Where the debtor is party to such an arrangement, however, the parties cannot validly agree to change the statutory order of priority pursuant to German insolvency law. As an exemption from this rule, a creditor could agree to become deeply subordinated in the insolvency of its debtor. However, this is usually not intended by customary "waterfall" or "priority of payments" arrangements because such an arrangement would benefit all other creditors and not only the creditors party to the "waterfall" arrangements. Rather, in an insolvency of the debtor, the creditors that are party to such arrangements would constitute creditors of the same rank for insolvency law purposes and be obligated to distribute any amounts received among themselves according to the priorities agreed.

**7.6 Independent Director.** Will a court in Germany give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

In the case of German SPEs (which are generally in the form of

limited liability companies), such a provision would be generally given effect to independently of the governing law, provided that the parties have validly chosen such law in accordance with the rules described in question 2.3 above. However, the statutory obligation to file for the opening of an insolvency proceeding where the company is either unable to pay its debts as they become due or over-indebted, and the incurrence by management of personal liability for damages and criminal liability upon a breach of such obligation, would remain unaffected by any non-petition clause in the transaction documents or the *GmbH's* organisational documents.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc.** Assuming that the purchaser does no other business in Germany, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Germany? Does the answer to the preceding question change if the purchaser does business with other sellers in Germany?

The general view in the market is that, as a securitisation transaction does not involve the transfer of any undrawn commitments, the purchase and ownership of receivables by the purchaser, and its collection and enforcement of receivables owned by itself, do not trigger any licensing requirements in Germany. The German bank regulator has confirmed this view for revolving securitisations in connection with the introduction of a new licensing requirement for factoring services providers.

**8.2 Servicing.** Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

The collection and enforcement of the sold receivables by the purchaser itself does not trigger any licensing requirements in Germany. However, where the receivables are serviced by a third party on behalf of the purchaser, such party generally must be registered under the German Legal Services Act. An exception from the registration requirement applies where the seller continues servicing the sold receivables that were originated by itself. Consequently, as a practical matter, this registration requirement becomes relevant only in the case of a transfer of the servicing to a replacement servicer. In addition, any servicer must comply with German data protection laws.

**8.3 Data Protection.** Does Germany have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Germany has data protection laws, the most important of which is the Federal Data Protection Act, which restricts the use and dissemination of data about, or provided by, obligors. This law applies only to personal data relating to individuals (including individuals in their capacity as merchants or employees) and, in the view of some commentators, partnerships that have individuals as partners. The law provides that, where the affected individual has not consented to the transfer of personal data, such transfer is



permissible only if the transferor's interest in transferring the data outweighs the affected individual's interest in avoiding such transfer. The predominant view is that, in a typically structured securitisation transaction, this analysis generally results in the permissibility of the transfer of data. The argument in favour of this conclusion is even stronger where a securitisation transaction is structured so that it involves a data trustee as referred to in the German bank regulator's securitisation release described below (which is, however, not always the case where non-bank assets are being sold).

Independently of data protection laws, banks are subject to bank secrecy restrictions *vis-à-vis* their customers (individuals or other customers). These restrictions are considered to be of a contractual nature. The standard business terms of German banks generally address these expressly, but even where there is no such express provision, German courts consider banks to be bound by an implicit restriction. In 1997, the German bank regulator issued a release on the securitisation of German bank assets, which also addressed bank secrecy requirements. The regulator took the position that bank secrecy is complied with as long as the seller bank continues to service the bank loans sold because no transfer of obligor-related information to the purchaser is required. Where a back-up servicer is appointed, the regulator generally requires it to be a credit institution based within the EU or the European Economic Area. In any event, the regulator considers disclosure of information permissible: (i) to the extent required for an effective assignment, if the purchaser receives obligor-related information in anonymised form, with the complete set of information being deposited with an independent data trustee; and (ii) to the extent that information is "strictly technically required" to be passed on, and passed on in anonymised form, to third parties (such as rating agencies, auditing firms or security trustees) that are also bound by a confidentiality obligation. Although the views expressed by the German bank regulator are not binding upon German courts, they are generally considered to be of persuasive value. The general view in the German market is that bank secrecy is not violated in a securitisation transaction that is structured so as to comply with the requirements set out in the 1997 release. In addition, the German bank regulator stated in a release in 2007 that it will consider, in light of the 2007 German Supreme Court's decision described in question 4.4, whether the requirements set forth in the 1997 release have to be revised.

Neither data protection nor bank secrecy is an issue where the obligor has approved the transfer of the relevant data. Such approval may be contained in a general consent to a sale and assignment of receivables for refinancing purposes. Some German banks have recently amended their standard business terms to that effect. However, such consent is probably invalid if contained in standard business terms permitting the assumption of the entire loan contract by a purchaser, unless the purchaser is identified in the standard business terms or the obligor is given the right to terminate the loan in case the loan contract is transferred (see question 4.3 above).

---

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Germany? Briefly, what is required?**

---

As a general rule, the originator of the receivables (i.e., the seller) is primarily responsible for compliance with German consumer protection laws. Non-compliance may affect the validity of the receivables contracts or give the obligor a rescission right. Consequently, the purchaser needs to review whether the seller has

been in compliance with these laws. In addition, it is customary for the seller to give the purchaser corresponding representation and warranties. Consumer protection laws become particularly relevant in respect of loan agreements, receivables contracts entered into at the place of abode of the obligor, and receivables contracts that are based upon the seller's standard business terms.

The following German consumer protection laws relating to consumer loans should be noted: a lender must notify its consumer obligor three months before an agreed interest rate expires or the loan matures, stating whether it is willing to agree on a new interest rate or to extend the loan. This obligation also applies to a purchaser of the loan, unless the seller and the purchaser agreed that the seller shall exclusively continue dealing with the consumer obligor. Furthermore, a lender (and a purchaser of a loan) may accelerate an annuity loan in case of a payment default only if the consumer obligor is in default with at least two consecutive amortisation instalments and if the aggregate amount of arrears totals at least 2.5 to 10 per cent of the principal amount of the loan (depending on the loan's term and whether it is secured by real estate).

---

**8.5 Currency Restrictions. Does Germany have laws restricting the exchange of Germany's currency for other currencies or the making of payments in Germany's currency to persons outside the country?**

---

Germany has no such laws (with the exception of those implementing United Nations, EU or other international sanctions in respect of transactions with certain countries and persons). Where a German resident receives from, or makes payments to, non-German residents, the German resident must in certain circumstances notify such payments to Deutsche Bundesbank. However, such notification serves for statistical purposes only, and failure to notify does not affect the payment or the underlying obligation.

---

## 9 Taxation

---

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Germany? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

---

Payments on receivables (including interest payments) are generally not subject to withholding taxes in Germany. Withholding taxes in Germany would apply only in limited circumstances:

Withholding tax at a rate of 26.375 per cent may apply if the receivables qualify as hybrid debt instruments (e.g., participating loans, profit-contingent or convertible bonds). Payment obligations that are contingent on the obligor's liquidity (availability of funds) may be sufficient to characterise a loan arrangement as participating. If the seller or purchaser (i.e., the economic owner of the receivable) is a German tax resident (or acts through a German permanent establishment), the withholding tax can be credited or

refunded upon assessment. A non-German tax resident may be entitled to a refund of withholding tax under a tax treaty and, if it is a corporation, to a reduced withholding tax rate of 15.825 per cent under German domestic tax law.

Furthermore, German tax authorities have the power to order an obligor to withhold tax at a rate of 26.375 per cent (or 15.825 per cent in case of a corporate taxpayer) on payments to a purchaser (economic owner) tax resident outside Germany if the payment is subject to tax in Germany and this appears appropriate to safeguard Germany's taxation right. As a non-German tax resident purchaser is generally not subject to tax in Germany with payments on receivables, this power applies only in very limited circumstances, for example if interest payments are made on receivables that are secured by German *situs* real estate. Tax withheld can be credited or refunded upon assessment of the purchaser.

Non-interest bearing payment claims with a maturity of more than one year are generally bifurcated into a principal portion and an interest portion. For purposes of computing the interest portion, a rate of 5.5 per cent *per annum* is applied. The sale of trade receivables at a discount, as such, does not result in a risk that the discount amount may be recharacterised in whole or in part as interest. In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, however, there is a risk that the deferred purchase price would be recharacterised in part as interest if the deferral lasted for more than one year. However, such interest element would only be subject to withholding tax in the narrow circumstances described above.

#### **9.2 Seller Tax Accounting. Does Germany require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

Germany has not adopted any specific accounting policy for tax purposes in the context of a securitisation. German tax law generally follows German GAAP. The concept of economic ownership under German GAAP and German tax law is essentially the same. The answer to the question whether the seller or the purchaser has to show the assigned receivables in its tax balance sheet depends on whether the sale of the receivables can be considered a true sale or a secured loan, i.e., whether economic ownership in the receivables has been transferred. Economic ownership of the receivables generally remains with the seller if the seller continues to bear the credit risk associated with the receivables. This is the case, for example, where the amounts retained by the purchaser to cover credit risk (e.g., purchase price discounts) significantly exceed the expectable default rate and are refundable (if the credit risk does not materialise). The treatment under IFRS or US GAAP is not decisive for German tax purposes.

#### **9.3 Stamp Duty, etc. Does Germany impose stamp duty or other documentary taxes on sales of receivables?**

Germany does not impose a stamp duty or other documentary taxes on sales of receivables. On 14 February 2013, however, the European Commission published a draft directive for the introduction of a financial transaction tax in eleven EU Member States (including Germany). The sale of securitised receivables may, therefore, become subject to financial transaction tax in the future. Further legislative steps at the EU and Member States levels are outstanding that would have to be finalised before the financial transaction tax can enter into force. The timing of such legislative steps is currently uncertain. Also, since the directive is only in draft

form and certain aspects of the financial transaction tax have raised legal concerns, the scope of the proposed tax is still uncertain.

#### **9.4 Value Added Taxes. Does Germany impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

Germany generally imposes value added tax at a rate of 19 per cent on sales of goods or services. The sale of receivables is exempt from value added tax (but the seller can generally elect to waive this exemption). We believe that this exemption also applies where the purchaser not only acquires the receivable but assumes the entire contractual relationship with the obligor (but see the Swiss Re decision of the European Court of Justice (ECJ) of 22 October 2009).

In general, Germany also imposes value added tax on fees for collection agent services. In consequence of the *MKG-Kraftfahrzeuge-Factoring GmbH* decision of the ECJ of 26 June 2003 (the "*MKG decision*"), the German tax authorities consider the purchaser of receivables to be rendering taxable collection services (also referred to as "factoring services") to the seller when the purchaser assumes the actual collection of the receivable. The value added tax for such factoring services is generally assessed on the difference between the nominal value of the receivables assigned and the purchase price for such receivables, minus the value added tax included in such difference. The German tax administration has applied special rules to determine the assessment basis with respect to distressed receivables. Following the principles established by a preliminary ruling of the ECJ in the matter of *GFKL* dated 27 October 2011, however, the German Federal Tax Court decided on 26 January 2012 that the purchase of distressed (non-performing) receivables does generally not constitute a service by the purchaser to the seller (notwithstanding that the purchaser collects the receivables) and, consequently, is not subject to value added tax.

In view of the German tax authorities, no taxable collection services are being rendered by the purchaser where the seller continues to collect the receivables after the sale, as is typically the case in securitisation transactions. In this case, the collection of the receivables by the seller is not treated as a separate service to the purchaser, provided that, in collecting the receivables, the seller acts in its own interest and on the basis of its own, retained right. Even when the seller's activity is based on a separate agreement, such activity does not give rise to taxable collection services. It is then viewed as a supplementary service to a tax-exempt transaction and therefore the fees for such collection agent services are also exempt from value added tax. The predominant view among market participants is that, due to the aforementioned interpretation, the issues created by the *MKG* decision have been resolved for typical German securitisation transactions.

#### **9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

The tax authorities are able to make claims against the purchaser for unpaid value added tax when the seller was required to pay such value added tax on a sale of goods or services that gave rise to the

receivables. The tax authorities may only make claims against the purchaser if, and to the extent, the purchaser collects the receivables.

The purchaser is deemed to have collected the receivables in full if the purchaser grants a second assignment (or pledge) of the receivables to a third person (including a security assignment or pledge of the purchased receivables to a security trustee). This also applies when the purchaser receives no consideration for this second assignment.

Pursuant to guidance issued by the German tax authorities, the receivables are “deemed not to have been collected by the purchaser” (so that no liability arises) if, and to the extent, the purchaser pays consideration for the receivables to the free disposition of the seller. On this basis, the risk of the purchaser becoming liable for value added tax in a typical securitisation transaction is generally limited to the value added tax contained in the difference between the nominal amount of the receivables sold and the purchase price paid by the seller, e.g., due to discounts and cash reserves.

---

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Germany, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Germany?**

---

In general, the purchase of receivables would not make a purchaser that conducts no other business in Germany liable to tax in Germany. Exceptions may apply if the receivables give rise to income from German sources (as defined in German tax law). In some cases (e.g., interest payments on hybrid debt instruments), the purchaser’s liability to tax in Germany is then satisfied through withholding (*see* question 9.1 above). In other cases, the purchaser’s (corporate) income tax liability is assessed on the basis of its net income from German sources. For example, interest payments on loans secured by German *situs* real estate give rise to

a tax liability and a filing obligation in Germany under domestic law (*see* question 9.1 above). In many of its income tax treaties, Germany waives the right to tax interest on loans secured by German *situs* real estate.

The appointment of the seller as the purchaser’s service and collection agent, or the purchaser’s enforcement of the receivables against the obligors, should not ordinarily make the purchaser liable to tax in Germany. However, the German tax authorities have, in the past, indicated that they may treat the purchaser as a resident of Germany for tax purposes if the purchaser is an entity that has no substantial presence outside of Germany. In this case, the purchaser may be treated as having its effective place of management in Germany because the seller in its capacity as servicer and collection agent makes the decisions relating to the day-to-day management of the purchaser’s business (in particular, the enforcement of the receivables against the obligors) in Germany. As a result, the purchaser would be subject to German (corporate) income tax and trade tax.

Even where it can be established that a purchaser is effectively managed from outside Germany, the purchaser may still have a taxable presence in Germany if the tax authorities consider the seller as a dependent agent in Germany due to its collection services for the purchaser. This mainly depends on whether the seller is bound by the instructions of the purchaser. If the purchaser agrees that the seller can continue the collection on its own terms and the purchaser has no possibility to intervene, a point can be made that the seller is not acting as a dependent agent.

### Acknowledgment

We would like to gratefully acknowledge the contribution by Daniel Ludwig, an associate at Cleary Gottlieb’s Frankfurt office, to this chapter. Furthermore, we would like to gratefully acknowledge the contribution by Dr. J. F. Daniel Weyde, a partner at Cleary Gottlieb’s Frankfurt office, of the descriptions in this chapter relating to German tax.

**Dr. Werner Meier**

Cleary Gottlieb Steen & Hamilton LLP  
Main Tower, Neue Mainzer Strasse 52  
60311 Frankfurt am Main  
Germany

Tel: +49 69 97 103 0  
Fax: +49 69 97 103 199  
Email: [wmeier@cgsh.com](mailto:wmeier@cgsh.com)  
URL: [www.cgsh.com](http://www.cgsh.com)

Werner Meier is a partner at Cleary Gottlieb's Frankfurt office. Dr. Meier's practice spans German and international financing, restructuring and capital markets transactions. In recent years, he has focused on German debt and corporate restructurings, as well as syndicated loans, securitisations and other structured finance transactions. Dr. Meier has worked on numerous German, pan-European and U.S. securitisation and other structured finance transactions, including the first synthetic securitisation in history. He has also acted as counsel to Standard & Poor's on numerous synthetic and true sale securitisations, secured loan and other structured finance transactions in Germany. Dr. Meier joined Cleary Gottlieb in 1992 and was resident in the firm's New York office from 1995 to 1996. He holds a doctorate degree in law (*Dr. iur.*) and obtained an LL.M. degree from Columbia University in 1991 and an MBA (*Diplom-Kaufmann*) in business administration from the Business School of the University of Bielefeld in 1990. He completed his German legal education and practical training in 1989. He is a member of the Bar in New York and admitted to practice in the Federal Republic of Germany. Dr. Meier is widely published on German and U.S. capital markets, structured finance, corporate law and insolvency law issues. He is distinguished as a leading German finance and restructuring lawyer by Chambers Global, Chambers Europe, European Legal 500, Legal 500 Deutschland and JUVE.

**Michael Kern**

Cleary Gottlieb Steen & Hamilton LLP  
Main Tower, Neue Mainzer Strasse 52  
60311 Frankfurt am Main  
Germany

Tel: +49 69 97 103 0  
Fax: +49 69 97 103 199  
Email: [mkern@cgsh.com](mailto:mkern@cgsh.com)  
URL: [www.cgsh.com](http://www.cgsh.com)

Michael Kern is a senior attorney at Cleary Gottlieb's Frankfurt office. Mr. Kern's practice focuses on insolvency, real estate and banking law. He has worked on numerous securitisation transactions. Mr. Kern joined Cleary Gottlieb in 2000. He passed the second state examination in the State of Hesse in 1998 and the first state examination at the University of Frankfurt am Main in 1996. Mr. Kern is admitted to practice in the Federal Republic of Germany. He has been distinguished as a recommended German finance lawyer by Chambers Global.

## CLEARY GOTTLIEB

A leading international law firm with 16 offices located in major financial centres around the world, Cleary Gottlieb Steen & Hamilton LLP has helped shape the globalisation of the legal profession for more than 65 years. Our worldwide practice has a proven track record for innovation and providing work of the highest quality to meet the needs of our domestic and international clients. In recognition of the firm's strong global practice, its effectiveness in dealing with the different business cultures of the countries in which it operates, and its success in multiple jurisdictions, Cleary Gottlieb received Chambers & Partners' inaugural International Law Firm of the Year award.

Our clients include multinational corporations, international financial institutions, sovereign governments and their agencies, as well as domestic corporations and financial institutions in the countries where our offices are located. Although each of our 16 offices has its own practice, our "one firm" approach to the practice of law offers clients in any office the ability to access the full resources of all of our offices and lawyers worldwide to the extent their matters so require.

Ever since Cleary Gottlieb helped develop the first collateralised mortgage obligation in 1983, the firm has been a recognised leader in the field of financial asset securitisation. Lawyers in the Frankfurt office have participated in some of the most innovative transactions involving the creation of asset-backed securities in Germany.

# Hong Kong



Paul McBride



Michael Capsalis

King & Wood Mallesons

## 1 Receivables Contracts

- 1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

Other than with respect to certain types of contracts (and provided that the common law requirements of contract formation, such as offer, acceptance, consideration, legal formalities and capacity are met), there is no general requirement under Hong Kong law that a sale of goods or services be evidenced by a formal contract (assuming “formal” means an agreement be in writing or evidenced in writing). As such, it is possible for a contract to arise solely from the behaviour of the seller and obligor in the absence of a written contract to the contrary.

An invoice, depending on the detail and nature of its terms, may be sufficient to evidence a contract between the obligor and the seller. In particular, an invoice may incorporate, by way of reference, the seller’s standard terms and conditions. Furthermore, a court in Hong Kong may also imply further terms by examining the course of previous dealings between the obligor and the seller or imply terms which may arise by custom or trade usage within a particular industry.

- 1.2 Consumer Protections. Do Hong Kong’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

Yes, there are Hong Kong laws that may limit the applicable rates of interest. The Money Lenders Ordinance (Cap. 163) operates to limit rates of interest in certain circumstances. In particular, any loan agreement that contains a provision requiring the payment of interest where:

- (a) the rate of interest exceeds 48 per cent. – is deemed to be extortionate and the terms of such an agreement are susceptible to amendment by a Hong Kong court; or
- (b) the rate of interest exceeds 60 per cent. – is rendered unenforceable (together with any security provided to support such loan) and is a criminal offence with a maximum penalty of HK\$5,000,000 and 10 years’ imprisonment.

In this context, the Money Lenders Ordinance does not apply to “authorized institutions” as lenders as defined in the Banking Ordinance (Cap. 155) nor does it apply to loans made to a company with paid up share capital of at least HK\$1,000,000.

A provision in a contract which provides for the payment of an additional sum of money upon breach of the contract may amount to a penalty and be unenforceable under Hong Kong law if the sum stipulated to be paid for such a breach is not a genuine pre-estimate of the greatest conceivable loss likely to be suffered by the non-defaulting party.

There is no general consumer protection legislation in Hong Kong. However, there are specific regulations which are relevant in certain industries, such as insurance and structured products. In addition to the Money Lenders Ordinance, there are also several ordinances of general application which may provide rights to consumers, such as the Control of Exemption Clauses Ordinance (Cap. 71), Supply of Services (Implied Terms) Ordinance (Cap. 457) and Unconscionable Contracts Ordinance (Cap. 458). Please see the response to question 8.4 below for further details.

- 1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

Contracts entered into by the government or a governmental body are governed by ordinary principles of Hong Kong law, subject to, in the case of a governmental body, any limitations that may be set out in the statutory instrument that establishes such body.

Neither sovereign immunity nor crown immunity applies to the Hong Kong government and its entities. The Hong Kong government has effectively waived its immunity from legal proceedings under the Crown Proceedings Ordinance (Cap. 300).

However, care must be taken to distinguish contractual arrangements with the Hong Kong government and contractual arrangements with the mainland government of the People’s Republic of China. The *Hua Tian Long* (No. 3) [2010] 3 HKC 557 decision confirmed that the mainland government of the PRC is entitled in certain circumstances to exercise crown immunity before the Hong Kong courts unless waived. The essential test is whether the counterparty can be considered an instrumentality of the PRC government or any of its ministries and regional counterparts. Other factors include whether: (a) the board of directors are able to exercise independent discretion; (b) the entity is managed and/or established by a PRC state or government entity; (c) whether it has statutory powers conferred upon it or carried out the functions of a

PRC state or government entity; and (d) whether it is required to seek approval for its day-to-day or commercial operations by any PRC state or governmental entity.

## 2 Choice of Law - Receivables Contracts

**2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Hong Kong that will determine the governing law of the contract?**

In the absence of a choice of law provision, the courts of Hong Kong would look to the jurisdiction which has the most real and substantial connection to the dispute.

**2.2 Base Case. If the seller and the obligor are both resident in Hong Kong, and the transactions giving rise to the receivables and the payment of the receivables take place in Hong Kong, and the seller and the obligor choose the law of Hong Kong to govern the receivables contract, is there any reason why a court in Hong Kong would not give effect to their choice of law?**

There is no reason.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Hong Kong but the obligor is not, or if the obligor is resident in Hong Kong but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Hong Kong give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

Hong Kong courts will generally give effect to the choice of foreign law, provided that such choice has been made *bona fide* and is not against public policy.

Notwithstanding the valid choice of a foreign law to govern the receivables contract, Hong Kong mandatory laws may nevertheless apply to certain aspects of any agreement between the obligor and the seller. For example, transfers of an interest in land would be governed by Hong Kong law, irrespective of the otherwise valid choice of a foreign law to govern the contract.

**2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Hong Kong?**

It is not clear whether the CISG applies in Hong Kong. The Hong Kong Department of Justice does not list the CISG as a treaty applicable to Hong Kong.

Furthermore, there is inconsistent international case law and commentary as to whether declarations made by the People's Republic of China have:

- by an affirmative declaration (as contemplated under article 93 of the CISG), excluded the CISG from applying to Hong Kong (being a territory of the PRC); or
- failed to make an affirmative declaration, with the result that (by operation of article 93(4) of the CISG) the CISG automatically applies to Hong Kong.

## 3 Choice of Law - Receivables Purchase Agreement

**3.1 Base Case. Does Hong Kong's law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Hong Kong's laws or foreign laws)?**

No, Hong Kong law does not require the sale of the receivables to be governed by the same governing law as the receivables themselves.

However, if the receivables contract is governed by Hong Kong law, the assignment of the receivables would be subject to perfection requirements as established under Hong Kong law. This is in addition to the issues set out above in the response to question 2.3 (i.e., Hong Kong mandatory laws).

**3.2 Example 1: If (a) the seller and the obligor are located in Hong Kong, (b) the receivable is governed by the law of Hong Kong, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Hong Kong to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Hong Kong, will a court in Hong Kong recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?**

Yes, a court in Hong Kong will recognise the sale as being effective against the seller, the obligor and third parties.

For this response and the responses below, we have assumed that "located in Hong Kong" means that the relevant party is (for a company) incorporated in Hong Kong, rather than a non-Hong Kong company that has an established place of business in Hong Kong and registered under Part 16 of the Companies Ordinance (Cap. 622). Whether the sale of the receivables is upheld as a "true sale" against the insolvent estate of a non-Hong Kong company depends on the insolvency laws of the jurisdiction of incorporation of that company.

**3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Hong Kong, will a court in Hong Kong recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?**

Yes, a court in Hong Kong will recognise the sale as being effective against the seller and third parties.

**3.4 Example 3: If (a) the seller is located in Hong Kong but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Hong Kong recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Hong Kong's own sale requirements?**

In the event of enforcement against the seller before any insolvency

proceeding in relation to it, it is likely that a Hong Kong court will recognise the sale as valid and enforceable against the seller (assuming of course the receivables purchase agreement is itself valid, binding and enforceable). As the relevant agreements in this scenario are governed by non-Hong Kong law, the situation envisaged here is enforcement post-foreign judgment against the seller. The response to this question therefore turns on whether a Hong Kong court would recognise and enforce a foreign judgment against the seller (for example, it may not be enforceable if it is against Hong Kong public policy).

However, notwithstanding that the transaction is recognised as a sale by the laws of the obligor's jurisdiction, in the event of insolvency proceedings commencing with respect to the seller, it is likely that a Hong Kong court would apply Hong Kong law true sale analysis to the transaction to determine whether it is treated as a true sale in accordance with the legal tests set out in the response to question 4.9 below.

**3.5 Example 4: If (a) the obligor is located in Hong Kong but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Hong Kong recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Hong Kong's own sale requirements?**

There is no requirement in Hong Kong that the sale be in accordance with Hong Kong law for it to be enforceable against the obligor (subject to the limitations listed in the response to question 4.4). However, the question of whether the receivable is enforceable by the purchaser against a Hong Kong obligor depends on the nature of the receivable and the identity and characteristics of the obligor (for example, if the obligor is a consumer, he or she may have remedies available under Hong Kong law notwithstanding the location of the seller or purchaser or the governing law of the receivable – as further set out in the response to question 8.4 below).

**3.6 Example 5: If (a) the seller is located in Hong Kong (irrespective of the obligor's location), (b) the receivable is governed by the law of Hong Kong, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Hong Kong recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Hong Kong and any third party creditor or insolvency administrator of any such obligor)?**

As noted in the response to question 3.4 above, on the insolvency of the Hong Kong seller, a court in Hong Kong is likely to apply Hong Kong law true sale analysis to determine whether it is treated as a sale or a secured transaction.

For an obligor located in Hong Kong, the same considerations as set out in the response to question 3.5 apply. True sale analysis is not relevant with respect to the obligor, as its obligations under the receivables contract remain unchanged irrespective of whether the sale amounts to a sale or to a secured transaction between the seller and the purchaser.

## 4 Asset Sales

**4.1 Sale Methods Generally. In Hong Kong what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

The customary method to sell receivables in Hong Kong is a legal or equitable assignment by way of sale. However, receivables may also be sold by way of novation or through a declaration of trust. The term "transfer" has no legal meaning under Hong Kong law but is typically synonymous with a legal or equitable assignment.

A legal assignment is an assignment which meets the criteria set out in Law Amendment and Reform (Consolidation) Ordinance (Cap. 23), being:

- (a) an absolute assignment by way of sale of the assignor's entire legal interest in the receivables;
- (b) in writing and signed by the assignor; and
- (c) with express written notice of the assignment (in particular the date of assignment and the identity of the assignee) given to the obligor. The notice need not be in any particular form and may be given by any party.

An equitable assignment is an assignment which has not met all the required criteria necessary to create a legal assignment. Typically an equitable assignment arises due to a commercial or practical decision to not provide notice to the obligor at the time of assignment. Nevertheless, courts of Hong Kong recognise an equitable assignment, but such an assignment has a number of practical and legal limitations (for example, priority is affected as set out in the response to question 4.2 below).

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

The requirements to perfect the sale of receivables are, for an assignment by way of sale, set out in the criteria to establish a legal assignment in the response to question 4.1 above.

Perfection and priority against a subsequent good faith purchaser for value of the same receivables requires notice to be given to the obligor before the subsequent good faith purchaser has given its notice to the same obligor (unless the subsequent purchaser had knowledge of the earlier assignment at the time that they were assigned the same receivables).

**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

The sale of promissory notes is governed by the Bills of Exchange Ordinance (Cap. 19), which requires transfer by way of delivery or by way of endorsement and delivery.

For the sale of mortgage loans, the Conveyancing and Property Ordinance (Cap. 219) requires that the assignment of any equitable interest in land be created or disposed of by an instrument in writing and signed by the person creating or disposing of the equitable interest. The assignment of a mortgage loan must also be registered with the Land Registry pursuant to the Land Registration Ordinance (Cap. 128) within one month of the assignment in order to maintain priority over subsequent interests in the same land.

Marketable debt securities may either be in bearer form or registered form. By their very nature, bearer notes only require delivery of the relevant instrument from the seller to the purchaser in order to transfer title. The sale and transfer of ownership of registered notes requires an entry to be made to a register maintained by a registrar on behalf of the issuer of the registered notes. It is only when such register is updated that legal ownership in the notes is transferred from the seller to the purchaser. Please see the response to question 5.5 below for further information.

For consumer loans, please see the response to question 8.4 below.

---

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

---

Notification to the obligor is not mandatory in order for the sale of receivables to be effective against the obligor or creditors of the seller. However, as noted above in the response to question 4.1, there are a number of practical and legal difficulties that arise from an assignment without notice to the obligor (that is, an equitable assignment rather than a legal assignment). Therefore, unless notice is given, the following issues may arise:

- (a) the obligor may discharge its liabilities by making payments solely to the seller, regardless of whether the seller must account to the purchaser for moneys received from the obligor;
- (b) the obligor may claim set-off and raise equities and defences against the seller which it may not have been able to raise against the purchaser;
- (c) as set out in the response to question 4.2 above, a subsequent purchaser of the same receivables may give notice to the obligor prior to the purchaser such that they gain priority;
- (d) the purchaser must join the seller to any proceedings against the obligor; and
- (e) the seller and the obligor may amend the relevant receivables contract without the consent or knowledge of the purchaser (although, as a matter of practice, the seller would usually covenant not to do so under any receivables purchase agreement).

Consent from the obligor is required where the underlying receivables contract prohibits assignment of the contract to a third party. A sale will not be enforceable against the obligor if the assignment is made in breach of such a prohibition.

The assignment of a contract, where such contract is silent as to the ability of a party to assign its rights, will generally be valid and effective, although Hong Kong law prohibits assignment for certain specific types of contracts or where it is against public policy to do so.

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

---

There are no specific legal requirements as to the form of notice to be given to the obligor. However, English case law decided prior to 30 June 1997 and which continues to apply in Hong Kong (as developed by the common law in Hong Kong), has emphasised that any notice of assignment must, at the very least, specify the relevant date of such assignment and clearly specify the identity of the assignee. It must also be sufficiently clear as to the receivables being assigned. Furthermore, such notice must be expressly provided to the obligor – it is not sufficient that notice to the obligor be inferred or implied in the circumstances.

Notice may be given after the obligor or seller has entered insolvency proceedings.

English case law also has held that notice of assignment of a future receivable is not valid if such receivable had not come into existence before such notice was given.

---

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?**

---

Restrictions on assignment are generally enforceable in Hong Kong. It is not legally correct to state that an agreement is "assigned" or "transferred", but this is taken in laymen terms to mean the assignment of any rights arising under the relevant agreement. As such, whichever way the relevant clause is drafted, it is taken to be referring to the assignment of rights under the relevant agreement. The interpretation of assignment restriction clauses follows the English decision of *Linden Gardens Trust Limited v Lenesta Sludge Disposals Limited* [1994] 1 AC 85 (which has been considered by the courts of Hong Kong most recently in *Zhang Qiyun v Shun Shing Construction & Engineering Co Ltd* [2010] HKCU 604), which held that such a clause will be effective as against the obligor and the purchaser, but will not affect relationships between the obligor and seller and the seller and purchaser (i.e. the assignor will remain liable to the assignee for the failed assignment).

It is not possible to "transfer" or "assign" an obligation under Hong Kong law, this must be completed by way of novation, which would require express consent and agreement of both the seller and obligor (together with the purchaser). This is the case even if the "transfer" is by way of book entry only (i.e. the debiting of account with the simultaneous crediting of another account) as this is considered under English law to be a novation rather than an assignment (*R v Preddy* [1996] AC 815).



**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Hong Kong? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Hong Kong recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

Notwithstanding the general enforceability of a prohibition of assignment, the decision of *Don King (Productions) Inc v Warren* (No 1) [2000] Ch 291 affirmed that it is possible to establish a trust over the rights that the seller would have under the contract. Therefore, provided that there is no clear prohibition (which the *Barbados Trust Co Ltd v Bank of Zambia* [2007] EWCA Civ 148 decision confirmed could be enforceable and binding as against the seller) over establishing a trust over the rights of a contract, it is possible under Hong Kong law (assuming the Hong Kong courts follow the English common law position) to nevertheless replicate the commercial effect of assigning an interest in the receivables contract to the purchaser notwithstanding the existence of a prohibition of assignment clause.

If a seller sells a receivable in breach of contractual restriction of assignment, the seller may be liable to the obligor for breach of contract and the purchaser may be liable for the tort of inducing another (that is, the seller) to breach a contract.

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

The sale document must identify the receivables with such specificity such that they are capable of being ascertained, whether they are in existence or will come into existence in the future. Furthermore, a declaration of trust will not be validly established if there is a lack of certainty in the subject matter of the trust (being the receivables in this case).

There is no requirement that receivables share any objective characteristics.

It is sufficient to identify all receivables of the seller for the purposes of ascertaining which receivables are to be the subject of any receivable sale agreement.

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

The label which parties give to a transaction is not determinative as to the true characterisation of that transaction. As such, the fact that

the parties agree that the transaction be treated as a sale is one factor which a court in Hong Kong would consider when determining whether the transaction is a “true sale” or whether it should be characterised as another type of transaction (such as the granting of security or a secured loan).

The first step of any analysis is to examine whether the transaction is of a different legal nature than that which it purports to be. The Court of Appeal in *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148 used a two-stage test to determine the answer to this first question. Firstly, is the arrangement a sham intended to hide the true agreement reached between the parties? Secondly, assuming that the transaction is not a sham, what is the legal characterisation of the transaction between the parties?

The English decision of *Re George Inglefield Ltd* [1933] Ch 1 (which has been applied by the Hong Kong courts in the decision of *Hallmark Cards Inc v Yun Choy Ltd* [2012] 1 HKLRD 396) illustrates a number of factors which the court would consider when determining the answer to the second step of the analysis, by looking at whether a particular transaction is a sale or whether it amounts to a transaction involving the granting of security. The non-exhaustive factors include the following:

- (a) under a sale, the seller is not entitled to recover the property sold by returning the purchase money to the purchaser. In contrast, the provider of security is entitled to recover the property that is the subject of the transaction as a right called an “equity of redemption” upon return of the money (together with any interest or other amounts owed);
- (b) under a sale, the purchaser is free to sell the property without having to account for any profit to the seller. In contrast, the provider of security is entitled to any surplus arising from the sale of the property (after discharge of any secured obligations) that was subject to the relevant security interest; and
- (c) conversely, under a sale, if the purchaser sells the property at a loss, it cannot look to the seller to make good that loss, whereas under a secured transaction, the provider of security may be required to make good that loss to the security taker.

Notwithstanding the factors listed above, courts in Hong Kong (and England) have nevertheless found that a transaction amounts to a sale even though:

- (a) the purchaser has recourse against the seller to recover the shortfall if the obligor fails to pay the debt in full;
- (b) the purchaser may have to make adjustments and payments to the seller after the full amounts of the debts have been received from the obligor;
- (c) the seller remains as servicer and responsible for collections from the obligors; and
- (d) the seller assumes interest rate risk through the provision of any interest rate hedging arrangement.

Retaining control over collections will not, of itself, affect the true sale analysis. However, an unfettered right of the seller to repay the purchase price to repurchase all the receivables may undermine the true sale nature of the transaction.

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

Yes, under Hong Kong law the seller can agree to the continuous sale of receivables.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?**

Yes, under Hong Kong law the seller can agree to assign in equity receivables that come into existence after the date of the receivables purchase agreement. In such a case, the promise to transfer the receivables as they come into existence is enforced in equity so that the purchaser has a right to the receivables as soon as they come into existence. However, notice will still be required to the obligor in accordance with the Law Amendment and Reform (Consolidation) Ordinance to perfect such an assignment.

Note that the sale of any receivable after the date of a winding-up petition (assuming that a winding-up order has been made by a Hong Kong court) is void without court approval.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

The response to the question depends on the nature of the asset to which the related security relates. For example, a transfer of a mortgage in Hong Kong would require registration with the Land Registry offices.

In the event that related security cannot be transferred completely, a security taker may be able to rely on an equitable interest rather than a legal interest.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

The purchaser of a receivables contract will take the assigned rights “subject to equities”, being, in this context, any rights that the debtor has against the seller to set-off any amounts owing between the seller and the debtor that the debtor could have been able to set-off. Therefore, the purchaser has obtained a qualified right to the debt arising from the relevant receivable contract (*Tito v Waddell* (No 2) [1977] Ch 106). However, the right to set-off against the purchaser must have arisen before the relevant date of assignment and must be in relation to the receivables contract itself (*Business Computers Ltd v Anglo-African Leasing Ltd* [1977] 2 All ER 741) and the set-off amount must not exceed the sum due under the receivables contract to the purchaser (*Honour Finance Co Ltd v Chan Yan Pak* [1988] HKC 864).

Where there was a set-off right existing before the date of assignment, it is not strictly correct to state that the debtor’s set-off rights are ever “terminated” by an act of any other party. Rather, the debtor retains the right to answer any claim by the purchaser for the full amount by raising set-off in any proceedings in relation to that

claim. This is because, as a practical matter, it would be the purchaser who would initiate a claim for damages in any court proceeding for the full amount due under the receivables contract and it would be the debtor who would raise set-off as part of their defence of such claim.

However, for set-off rights that arise after the date of assignment (and subject to the set-off provisions of the receivable contract), the debtor cannot set-off against payments due to the purchaser under the receivable contract. As between the debtor and the seller (and, again, subject to any set-off provision), the debtor may still nevertheless continue to assert set-off rights against the seller.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Hong Kong to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

It is not customary in Hong Kong to take any form of security interest over the seller’s ownership in the receivables. The reason being that this may prejudice any true sale analysis as it may show an objective intention of the parties to treat the transaction as a security arrangement rather than a true sale of the receivables.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Hong Kong, and for such security interest to be perfected?**

Security created by way of charge over some assets must be registered in accordance with Section 335 of the Companies Ordinance (Cap. 622). Most relevant to the purchase of receivables is, among other things, the requirement to register charges over land and interests in land, charges over book debts of a company and floating charges over the property or undertaking of a company. “Company” in this context means companies incorporated in Hong Kong and a non-Hong Kong company registered under Part 16 of the Companies Ordinance (which must register the charges in accordance with section 336 of the Companies Ordinance (Cap. 622)).

Failure to register within one month after its creation renders the charge void as against any liquidator of the company and any third party creditor of the company. As such, registration is purely a perfection requirement against third parties and is not a condition to the validity of the charge as against the seller.

Perfection (with respect to priority over subsequent purchasers of the receivables) depends on whether the charge is fixed or floating. However, for practical reasons, it is unlikely that a fixed charge will be taken over receivables. Please see the response to question 5.3 below for further commentary on perfection and priority of security interests.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Hong Kong to grant and perfect a security interest in purchased receivables governed by the laws of Hong Kong and the related security?**

The formalities required to perfect security interests granted by the purchaser depend on the nature of the security interests granted over the purchased receivables.

For security interests granted by assignment by way of security, the legal assignment requirements as set out in the response to question 4.1 apply.

Security interests may also be granted by way of mortgage, fixed charge or floating charge. Although other forms of consensual security exist under Hong Kong law (i.e. pledge and lien), it is most likely that such security is provided by way of charge or mortgage. In Hong Kong, financing is usually secured by means of taking a fixed charge (or mortgage) over real property owned by the purchaser and a floating charge over the assets and undertaking of the purchaser.

Registration is required for some fixed charges, and all floating charges, in accordance with the Companies Ordinance (Cap. 622) (being within one month of the date of creation of such charge). Failure to register in accordance with the Companies Ordinance will render the charge void as against the liquidator of the purchaser as well as its creditors.

Perfection (with respect to priority over subsequent purchasers or subsequent chargors of the same assets) depends on whether the charge is fixed or floating. Assuming that the third party purchaser is acquiring the receivables in good faith and for value, the question of whether such a third party purchaser acquires priority over the previous security taker turns on the question of what notice such a third party purchaser actually had or is deemed to have (constructive notice).

In the case of a fixed charge, the chargor has neither actual nor ostensible authority to deal with the assets free of the fixed charge. As such, provided that the third party purchaser has actual notice (irrespective of whether they had notice of the terms of the relevant charging document) or deemed constructive notice of the existence of a fixed charge, the third party purchaser for value will have priority over the first security taker.

However, the application of the doctrine of constructive notice in relation to the existence of a floating charge is not so straightforward, as a third party subsequent purchaser (or subsequent chargor) is entitled to assume that the seller has the freedom to dispose of the receivables without actual notice to the contrary. As such, without actual notice of the content of the relevant charging document, establishing notice of any negative pledge or other restriction on disposal of the relevant asset is more difficult to achieve.

In either case, when determining priority between competing interests, a party will be held to have constructive notice of the existence of the fixed or floating charge on the basis of whether it could reasonably have been expected to search the register. That means that, for example, a third party purchaser buying goods in the ordinary course of business is unlikely to search the register whereas a financial institution taking security is likely to have deemed constructive notice of the existence of the charge.

With respect to notice of the contents of a charging documents, the Hong Kong decision of *ABN Amro Bank NV v Chiyu Banking Corporation Ltd and Ors* [2000] 3 HKC 381 held that it is only where a document must necessarily affect the title of third parties that notice of its existence would constitute constructive notice of the contents of that document. This reiterates the different approach that a court would take deeming constructive notice of the restrictions that apply to a fixed charge compared to the restrictions that may arise from a document granting a floating charge.

To the extent that security relates to assets such as land, ships or aircraft, special registration requirements apply under Hong Kong law.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Hong Kong, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Hong Kong or must additional steps be taken in Hong Kong?**

If the purchaser is a non-Hong Kong company that is registered under Part 16 of the Companies Ordinance (Cap. 622), it will be required to register any security in accordance with Hong Kong law (for example, a floating charge will need to be registered in accordance with the Companies Ordinance (Cap. 622), notwithstanding that the security interest is valid and perfected under the laws of the purchaser's country).

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

Security over insurance policies is typically achieved through assignment of the rights, title, interests and benefits in the insurance policy as well as an assignment of any proceeds received under such insurance policy to the secured party (or security trustee). An additional measure that is typically taken by secured parties is to have the secured party (or security trustee) recorded as a "loss payee" under the relevant insurance policy.

Security over promissory notes or marketable debt securities (in each case, where they are in definitive bearer form) is usually taken by way of a pledge – although definitive bearer instruments are very uncommon nowadays. Security over bearer instruments may also be made by such instruments being mortgaged by delivery.

Taking security over marketable debt securities is complex and depends on a number of factors. However, key points are summarised below:

- (a) if the debt securities are not cleared – for a legal mortgage, the security taker's name and details would be entered on the register maintained by the registrar of the relevant issuer until such time as the obligations of the security provider are discharged. For an equitable mortgage or charge, the security provider completes all necessary transfer certificates but transfer by way of registration is not effected until enforcement steps are undertaken by the security taker;
- (b) if the debt securities are cleared – for a legal mortgage, the security taker's name would be entered into the relevant securities account of an intermediary/custodian who itself holds an interest directly from the issuer or (as is most likely the case) from a higher-tier intermediary. Alternatively, security may be taken by way of an assignment of rights against the relevant intermediary together with an assignment of the rights, title and interests in or relating to the debt security; and
- (c) security taken over mortgage loans would typically be required to be registered with the Land Registry in Hong Kong in accordance with the Land Registration Ordinance (Cap. 128) as it creates or transfers an interest in real property. Please see the response to question 4.3 above for further information.

**5.6 Trusts. Does Hong Kong recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Yes, trusts are recognised under Hong Kong law.

**5.7 Bank Accounts. Does Hong Kong recognise escrow accounts? Can security be taken over a bank account located in Hong Kong? If so, what is the typical method? Would courts in Hong Kong recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Hong Kong?**

Yes, escrow accounts are recognised under Hong Kong law.

Security is typically taken over a bank account located in Hong Kong by the granting of either a fixed charge or a floating charge (which may crystallise (i.e. convert) into a fixed charge upon the occurrence of a default or other like circumstance under the relevant transaction documents).

A court in Hong Kong would generally recognise effective foreign law governed security over a bank account in Hong Kong, although ideal practice would be to have security over a Hong Kong bank account governed by Hong Kong law to minimise delays or complications in enforcement.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

In general, a secured party would control all cash flowing in and out of a bank account during enforcement. The ability of the secured party to enforce the security would remain subject to the terms agreed in the relevant security document establishing a charge over the bank account and, in particular, whether a floating charge over the bank account has crystallised into a fixed charge.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Yes. The granting of a floating charge over the bank account provides for (prior to crystallisation) the chargor to access funds in accordance with the terms and conditions of the relevant security document.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Hong Kong's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

Insolvency proceedings with respect to the seller will not affect the rights of the purchaser if the sale meets the requirements of a "true sale" or legal assignment under Hong Kong law.

The situation will be different if the sale was conducted as an equitable assignment (rather than a legal assignment or through novation). On the making of a winding-up order, or on the appointment of a provisional liquidator, with respect to the seller, it

may not be possible to compel the seller to perform its obligations under the relevant transaction documents without leave of the court.

If a transaction, which was intended by the parties to be a sale, is subsequently recharacterised as a secured transaction under Hong Kong law, there is a risk that such a transaction would be held void against the liquidator of the seller as well as creditors of the seller due to lack of registration in accordance with the Companies Ordinance (Cap. 622).

There are no formal corporate rescue procedures in the present regime in Hong Kong.

With the introduction of the new Companies Ordinance (Cap. 622) on the 3 March 2014, all of the sections except for the prospectus regime and the winding-up and insolvency provisions are now regulated by the new Companies Ordinance. These remaining sections remain under the old Companies Ordinance which has been renamed as the "Companies (Winding Up and Miscellaneous Provisions) Ordinance" (CWUMPO).

Various consultations by the government in Hong Kong over a number of years have outlined a proposal to introduce the concept of provisional supervision. The current proposals envisage such provisional supervision being initiated by filing a notice with the Companies Registry (without requiring court approval). This would then create a moratorium for, initially a 45-day period, where the provisional supervisor would prepare a voluntary agreement. Creditors will be able to extend the 45-day period up to a maximum of six months. A court will be able to extend the period for as long as it deems necessary.

Discussions and further consultations regarding this arrangement and its exemptions are still taking place and are yet to be finalised, with the government planning to introduce legislative proposals in 2014.

Additionally, the government and financial regulators published a consultation paper in January 2014 on proposals for a resolution regime in respect of certain financial institutions, which will provide authorities administrative powers to assist in ensuring the stability of relevant markets.

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

Please see the response to question 6.3 below.

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Hong Kong for (a) transactions between unrelated parties, and (b) transactions between related parties?**

There are a number of circumstances where pre-insolvency transactions may be set aside:

- (a) **unfair preference** (CWUMPO, sections 266(1) and 266B and Bankruptcy Ordinance (Cap. 6), section 50) – any disposition of any asset within six months (or two years for an unfair preference to an associate) before the commencement of winding-up of a company may be set aside where (i) it puts a person in a better position that it would otherwise have been on the insolvency of the company, and (ii) the company was influenced by a desire to create such preference;

- (b) **anti-deprivation rule** – any agreement which, on insolvency, increases a creditor’s claim or transfers assets to a particular creditor, is void. There is no preference or suspect period;
- (c) **invalidation of floating charges** (CWUMPO, section 267) – any floating charge created within one year before the commencement of winding-up of a company may be set aside where the company was insolvent or became so as a result of the entering into the charge or associated transactions, except to the extent of the value of any consideration received by the company on or after the creation of such floating charge (i.e. the floating charge remains valid to the extent that it secured fresh funds);
- (d) **extortionate credit transactions** (CWUMPO, section 264B) – a transaction entering into within three years of the commencement of winding-up of a company may be set aside where payments in relation to such a transaction are considered grossly exorbitant or the terms of the credit grossly contravene ordinary principles of fair dealing;
- (e) **transactions defrauding creditors** (Conveyancing and Property Ordinance (Cap. 219), section 60) – any disposition of property made with the intent to defraud creditors may be voidable. There is no preference or suspect period. However, such a claim would need to be made by a person prejudiced by such a disposition and would be subject to normal limitation periods; and
- (f) **disclaiming of onerous property** (CWUMPO, section 268) – the liquidator of a company may disclaim onerous property, which includes unprofitable contracts, effectively converting a counterparty’s rights under the relevant agreement into an unsecured claim. Again, there is no preference or suspect period.

---

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

---

There are limited circumstances under Hong Kong law where liabilities of a company may be imposed on another company. The typical circumstances are where the company was formed principally as a sham, to evade existing liabilities or to perpetrate a fraud.

---

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Hong Kong, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

---

The commencement of insolvency proceedings would have no immediate legal effect on either the sale of receivables after such proceedings have commenced or the sale of receivables that have come into existence after such proceedings have commenced. The general rule is that insolvency does not terminate contracts nor extinguish rights, although remedies are restricted post-insolvency.

One example in particular of this restriction is that, in the event that a court has granted a winding-up order with respect to a party, any disposition of the assets of such a party from the date that the winding-up petition was presented is void (or deemed void) unless the court otherwise approves.

Notwithstanding this, if there has been a true sale of the future receivables (for example, such that legal assignment has been perfected by the purchaser giving notice to the obligors), then subject to the issues outlined in the response to question 6.3 above,

the seller’s insolvency would not affect the purchaser’s rights in the relevant receivables.

---

**6.6 Effect of Limited Recourse Provisions. If a debtor’s contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

---

This issue recently arose for determination in the English decision of *ARM Asset Backed Securities S.A.* [2013] EWHC 3351 (Ch), where the court held that a Luxembourg company (with its centre of main interests determined to be in England) could be wound up where the court was satisfied that the company was unable to pay its debts, notwithstanding the inclusion of limited recourse wording (and “non-petition” wording – see our response to question 7.4 below) for the bonds which the company had issued. The court considered, among other things, the question of whether or not a company should be wound-up should be separate and unrelated from the question as to the quantum that creditors would receive from the liquidation of that company.

Such a question has not, to date, been considered by Hong Kong courts. Although persuasive, decisions of English courts are not binding on courts in Hong Kong. This case is unusual in that it was the directors of the issuer who petitioned the court rather than creditors of the issuer.

As a matter of market practice and drafting convention, documentation which contain limited recourse wording also invariably include non-petition clauses to limit the ability of creditors (but not directors) to seek to wind-up the relevant company. Therefore, it may be unlikely that the opportunity will arise for a Hong Kong court to consider a limited recourse provision in isolation from a non-petition provision.

---

## 7 Special Rules

---

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Hong Kong establishing a legal framework for securitisation transactions? If so, what are the basics?**

There are no laws in Hong Kong specifically for securitisation.

**7.2 Securitisation Entities. Does Hong Kong have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

There are no laws in Hong Kong specifically for the establishment of special purpose vehicles.

**7.3 Limited-Recourse Clause. Will a court in Hong Kong give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

It is likely that a Hong Kong court would give effect to a limited-

recourse clause, although there is no case law to date in Hong Kong which has considered its validity.

**7.4 Non-Petition Clause. Will a court in Hong Kong give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

It is likely that a Hong Kong court would give effect to a non-petition clause, although there is no case law to date in Hong Kong which has considered its validity. However, enforcing such a clause to prevent a party from taking legal action would require a court to exercise its discretion as to whether to grant an injunction or not – injunctive relief is not a right *per se* available to a plaintiff under Hong Kong law.

Similarly, the court in Hong Kong retains the discretion under the Companies Ordinance (Cap. 622) to have a company wound up where it is, in the opinion of the court, just and equitable to do so. As such, although unlikely, it is possible that a court exercises such discretion to allow insolvency proceedings to commence against the purchaser or another person.

**7.5 Priority of Payments "Waterfall". Will a court in Hong Kong give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

Waterfall or payment priority provisions are likely to be valid and enforceable under Hong Kong law for a Hong Kong law-governed document, although this has not been considered by any Hong Kong court to date. Assuming validity and enforceability under Hong Kong law, there is no reason why a court in Hong Kong would not give effect to such a clause with respect to a Hong Kong entity for a contract governed by a foreign law (subject to any foreign law-governed contract being void for public policy reasons or illegality in Hong Kong).

Although not binding on a Hong Kong court, the English Court of Appeal decision of *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383 has also affirmed the validity of "flip-clauses" which have the effect of altering the priority of payments upon an event of default (including insolvency) of a party to an agreement containing such a clause. As such, it is likely that a Hong Kong court would also uphold the validity of a "flip-clause" and, by necessary extension, the validity in general of priority of payment provisions.

**7.6 Independent Director. Will a court in Hong Kong give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

Provided that directors act in accordance with their fiduciary duties as directors and any requirements as set out in the Companies Ordinance and the Hong Kong listing rules (if applicable), there is no specific law which would prohibit contractual provisions or provisions in the company's memorandum and articles of association that prevent a director from acting or not acting in

particular circumstances. Of course, such provisions (whether in a Hong Kong law governed document or not) would remain subject to principles of general law, such as contracts being void for public policy reasons or illegality in Hong Kong.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Hong Kong, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Hong Kong? Does the answer to the preceding question change if the purchaser does business with other sellers in Hong Kong?**

Depending on the nature of the receivables, the purchaser may be required to obtain a particular licence or be subject to regulations. For example, the receivables may be relevant to business regulated by the Money Lenders Ordinance or the Banking Ordinance. If so, the purchaser will need to obtain the required licences or approvals before purchasing the relevant receivables.

A non-Hong Kong company must register in accordance with the Business Registration Ordinance (Cap. 310) if it is carrying on in Hong Kong "any form of trade, commerce, craftsmanship, profession, calling or other activity carried on for the purpose of gain". This is irrespective of whether it is required to register under Part 16 of the Companies Ordinance (see question 3.2). Please see the commentary below in question 9.6 as to whether mere ownership of receivables may result in the purchaser "carrying on a business" under Hong Kong law.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

There are no specific requirements under Hong Kong law to collect and enforce receivables (other than any requirements specific to the industry or nature of receivables).

**8.3 Data Protection. Does Hong Kong have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

Yes, in Hong Kong the Personal Data (Privacy) Ordinance (Cap. 486) ("PDPO") governs the collection, use and dissemination of personal data of living individuals. This does not apply to information with respect to enterprises.

The PDPO applies to anyone who collects or uses personal information which is capable of identifying an individual. In such circumstances, the "data user" must comply with a number of data protection principles that are set out in schedule 1 of the PDPO. In April 2013, criminal liability was introduced in respect of the new direct marketing provisions, which deal with unauthorised transfers of personal data to third parties for direct marketing purposes.

The Code of Banking Practice may also apply if the relevant entity is an "authorized institution" – please see the response to question 8.4 below. This imposes on such authorized institutions a duty to

maintain privacy when handling information relating to individual customers.

Data about, or provided by, obligors may also be protected by more general Hong Kong legal and regulatory principles that require the protection of confidential information. Largely, these apply irrespective of the legal structure of the obligor, but their precise application depends on the circumstances.

---

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Hong Kong? Briefly, what is required?**

---

Yes, a purchaser would be required to comply with certain consumer protection laws to the extent they apply with respect to the nature of the receivables and the identity and nature of the purchaser.

In particular (but not necessarily exhaustive):

- (a) the Banking Ordinance (Cap. 155) and the Code of Banking Practice where the purchaser is an “authorized institution” as defined in the Banking Ordinance – authorized institutions are expected to act in accordance with the Code when dealing with individual customers (please also see paragraph (g) below);
- (b) the Control of Exemption Clauses Ordinance (Cap. 71) – which limits the extent to which civil liability for breach of contract, or for negligence or other breach of duty, can be avoided by means of contract terms or otherwise;
- (c) the Money Lenders Ordinance (Cap. 163) – as discussed in the response to question 1.2 above;
- (d) the Supply of Services (Implied Terms) Ordinance (Cap. 457) – which implies certain reasonableness qualifiers to terms of a consumer contract in the absence of express terms;
- (e) the Unconscionable Contracts Ordinance (Cap. 458) – which grants to Hong Kong courts the power to determine that part or whole of a contract with a consumer may be unenforceable if found to be unconscionable;
- (f) the Trade Descriptions Ordinance (Cap. 362) – which prohibits false trade descriptions, false, misleading or incomplete information, false marks and misstatements in respect of goods and services, and in respect of services, includes further offences for misleading omissions, aggressive commercial practices, bait advertising, bait-and-switch and wrongly accepting payment; and
- (g) the various circulars and guidelines issued by the Securities and Futures Commission where the purchaser is licensed by the Securities and Futures Commission and by Hong Kong Monetary Authority where the purchaser is an “authorized institution” – which requires the purchaser in such circumstances to comply with such various circulars, codes and guidelines.

---

**8.5 Currency Restrictions. Does Hong Kong have laws restricting the exchange of Hong Kong's currency for other currencies or the making of payments in Hong Kong's currency to persons outside the country?**

---

There are no currency exchange controls in Hong Kong. However, the flow of funds in and out of Hong Kong may be restricted or prohibited by laws such as the United Nations Sanctions Ordinance (Cap. 537), the United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575), and related regulations.

The exchange of currencies is also generally confined to “authorized institutions” as defined in the Banking Ordinance and money changing service providers that are licensed under the Anti-

Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615).

---

## 9 Taxation

---

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Hong Kong? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

---

No, there is no withholding of taxes in Hong Kong. Whether any amount (such as a discount or deferred purchase price) is to be treated as interest for income tax purposes depends upon whether such amount satisfies sections 16(1) and 16(2) of the Inland Revenue Ordinance (Cap. 112) of Hong Kong. There are no specific provisions which deem a discount or deferred purchase price as being treated as interest for income tax purposes, although the Inland Revenue Department in Hong Kong has stated that its position, at least with respect to initial discounting of securities, is that such discount may be deductible as interest (amortised over the life of such security) provided that the tests in sections 16(1) and 16(2) are also satisfied. This conclusion is not, however, directly relevant to discounted receivables, which are not thought of as lending or borrowing arrangements.

---

**9.2 Seller Tax Accounting. Does Hong Kong require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

---

No, there is no specific accounting policy to be adopted for tax purposes in the context of securitisation. Hong Kong companies are required under the Companies Ordinance to prepare financial statements that give a true and fair view and are expected to prepare such statements under local GAAP (Hong Kong Financial Reporting Standards).

---

**9.3 Stamp Duty, etc. Does Hong Kong impose stamp duty or other documentary taxes on sales of receivables?**

---

No, there is no stamp duty on the sale of receivables. There is, however, stamp duty imposed on the transfer of interests in land (including the transfer of mortgages – although the collector of stamps in Hong Kong has been willing to adjudicate that a mortgage transfer is not subject to stamp duty) as well as on certain transfers of stock.

On 23 February 2013, new stamp duty rates for the sale or transfer of immovable property were introduced, ranging from 1.5 per cent. up to 8.5 per cent.

---

**9.4 Value Added Taxes. Does Hong Kong impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

---

There is no value added tax, sales tax or other similar taxes in Hong Kong.

**9.5 Purchaser Liability.** If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

There are no such taxes applicable in the context of the sale of receivables.

However, under Hong Kong law, tax may be recovered from a third party if the taxpayer is in default of their taxation payment obligations. Such outstanding taxes may be recovered from any third party who (i) owes or is about to pay money to the taxpayer, or (ii) holds money on account of another person for payment to the taxpayer, or (iii) has authority to pay money from some other person to the taxpayer. Failure to comply with a notice from the Commissioner of Inland Revenue may result in the third party becoming personally liable for the whole of the tax that was to be paid.



#### Paul McBride

King & Wood Mallesons  
13/F Gloucester Tower, The Landmark  
15 Queen's Road Central  
Hong Kong

Tel: +852 3443 1142  
Fax: +852 3443 1299  
Email: paul.mcbride@hk.kwm.com  
URL: www.kwm.com

Paul is a Partner in the firm's Securitisation team. He specialises in structured finance including securitisation, asset-based lending, derivatives and structured products across various asset classes and jurisdictions (including Australia, Hong Kong and other Asian countries). Paul also advises on debt capital markets and corporate lending transactions.

Paul's clients include arrangers, originators, issuers, swap counterparties, lenders, borrowers, monoline insurers, rating agencies and investors.

Paul worked in Tokyo and London for Linklaters prior to joining King & Wood Mallesons. Paul is rated as a leading practitioner by a number of market surveys, including most recently by Chambers Global in the area of Capital Markets: Securitisation. Paul is qualified in Hong Kong, England and Wales and New South Wales, Australia.

**9.6 Doing Business.** Assuming that the purchaser conducts no other business in Hong Kong, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Hong Kong?

There is a profits tax payable by every person "carrying on a trade, profession or business in Hong Kong" in respect of profits "arising or derived from Hong Kong ... from such trade, profession or business" (Inland Revenue Ordinance (Cap. 112)).

Whether a person is carrying on business is ultimately a question of fact having regard to the circumstances as a whole and determined by a number of indicia, with no single indicia being determinative. However, it is important to note that courts in England have considered that the passive receipt of share profits was held to be a business (*IRC v Korean Syndicate Ltd* (1921) 3 KB 258) as well as passive receipt of a fixed annuity (*South Behar Railway Co Ltd v IRC* (1925) AC 476).



#### Michael Capsalis

King & Wood Mallesons  
Level 50, Bourke Place  
600 Bourke Street  
Melbourne VIC 3000  
Australia

Tel: +61 3 9643 4323  
Fax: +61 3 9643 5999  
Email: michael.capsalis@au.kwm.com  
URL: www.kwm.com

Michael Capsalis is a solicitor in the Financial Markets group in Melbourne, Australia. He is qualified to advise on the laws of England & Wales and various Australian jurisdictions and has considerable experience in Hong Kong-related transactions.

Michael has broad experience across cross-border securitisation of various asset classes, derivatives, structured products and leveraged and mainstream banking. He has spent several years at Linklaters in London prior to joining King & Wood Mallesons in Hong Kong (subsequently transferring to the King & Wood Mallesons Melbourne office).

KING & WOOD  
MALLESONS  
金杜律师事务所

With the largest securitisation practice in the region, King & Wood Mallesons remains at the cutting-edge of new product development by financial institutions, investment banks and corporates. We have been involved in almost every landmark securitisation transaction in the Australian market and Asia, including most recently the first publicly listed and rated corporate loan securitisation backed by a guarantee from a Chinese export credit agency.

Drawing on our deep understanding of the global capital markets and local conditions, including specialists based in Hong Kong, Beijing and London, and market leading position across the spectrum of capital markets work, our team is advising on some of the most significant transactions in Asia. We have the leading deal list for the mature markets such as Hong Kong, Korea, Singapore and Australia and we have worked on more than half of the PRC securitisations. Our transactions also include Malaysia, India and New Zealand.

The team was recently named the Structured Finance and Securitisation Team of The Year at the IFRL Asia Awards, 2014.



# India

Dave & Girish & Co.

Mona Bhide



## 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

(a) It is not necessary under the Indian Contracts Act, 1872 that the contract for sale of goods or services be made in writing for it to be enforceable. However, in case of an assignment/securitisation, in order to ensure an undisputed flow of receivables, it is advisable that the underlying contracts which are proposed to be assigned are in writing and if one of the counter parties qualifies for a registration it should also be registered with the Central Registry (“CERSAI”) set up under the Central Registration of securitisation Asset Reconstruction and Secured Interests of India Act, 2002. An invoice coupled with a delivery receipt would also be sufficient evidence for the sale of goods. However, an assignment of the debt will be required to be evidenced by a written document that is duly stamped and registered with the CERSAI (facility available only to qualified lenders).

(b) To enforce the sale, an invoice would be sufficient evidence, except that in cases of assignment of book debts, in order that the transaction meets with the “true sale” criteria, in order to prove that the terms of assignment are in compliance with the Guidelines, it will be necessary to have a written document for assignment.

(c) A contract can be proved by the performance of the parties. If both parties perform their respective obligations, the contract becomes enforceable. However, such contracts are not easy to enforce as the evidence for such performance having been completed has to be proved beyond doubt. This is another reason why written evidence of the assignment as, and by way of, an agreement between the parties is necessary.

**1.2 Consumer Protections. Do Indian laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

(a) With respect to lending transactions, we do have statutes applicable in each state, which require each lender (which is not registered as a bank), to register as a moneylender. The

moneylenders’ statute also prescribes the maximum rate of interest that can be charged by a moneylender.

With a view to provide relief to farmers and other small entrepreneurs, some states in India have enacted laws/issued guidelines with respect to micro loans and limits have also been prescribed with respect to the rate of interest that can be charged on micro loans.

The rate of interest charged on late payments is based on the contract agreed by the parties in writing. While there is no prescribed rate of interest on late payments, if a matter is taken to court, the court may not award the interest as was agreed by the parties if the same is very high.

(b) While there is no statutory right to recover additional payment by way of interest on late payments, it is granted on equitable grounds in most cases. Where parties have agreed in writing under a mutual agreement that a rate of interest be charged, the courts would allow that rate of interest. However, if the court finds that the rate agreed is very high as compared to the current rate of interest prevailing in the market, the court may reduce the same at its discretion.

(c) No, consumers do not have a right to cancel the receivables except in case of a prepayment. Even prepayments will be allowed subject to such right being available under the underlying contract or unless mutually agreed to by all the concerned parties to the contract.

(d) Where a consumer is not informed about the assignment, the consumer has a right to continue to pay the original creditor/assignor. The consumer can also stop making payments if the original creditor undergoes a liquidation or becomes a sick company within the meaning of the Sick Industrial Companies Act, 1985, and/or is referred to the Board of Industrial and Financial Reconstruction on account of its net worth being totally eroded in cases where the consumer is not aware of the assignment.

The above answer is on the assumption that the underlying contract document does not restrict assignment or require any specific permission from the consumer.

Consumers have a right to challenge any unfair trade practice and any restrictive trade practices in special forums set up for this purpose. We also have a consumers’ forum that hears complaints of consumers, and decisions are binding on all.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

There is no different law that applies to the sale of receivables to the government or governmental agencies. However, in case of

bankruptcy of a company which is a government-owned company set up in India under a separate statute, the procedure for collection can be different and would be as prescribed under such statute.

## 2 Choice of Law - Receivables Contracts

### 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in India that will determine the governing law of the contract?

If all the parties to a contract are parties residing in India, even if the governing law of a contract is not specified in the contract, the governing law of such a contract will be Indian law by default.

Where, however, the contract is cross-border in nature and involves parties residing in different jurisdictions or where the subject matter of the contract is located in a foreign jurisdiction or where performance of the contract is carried out in a foreign jurisdiction and if the governing law is not specified in the agreement, the governing law of that contract will be decided having regard to the intention of the parties, and the law of the country with which it is most closely connected, the laws of the jurisdiction in which the parties are located, and the laws of the country in which the contract is to be performed. The Indian courts would apply the principles of private international law to decide any dispute arising with respect to the governing law of a cross-border contract.

### 2.2 Base Case. If the seller and the obligor are both resident in India, and the transactions giving rise to the receivables and the payment of the receivables take place in India, and the seller and the obligor choose Indian law to govern the receivables contract, is there any reason why a court in India would not give effect to their choice of law?

No, Indian courts would definitely give effect to the choice made by the parties.

### 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in India but the obligor is not, or if the obligor is resident in India but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in India give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such that between the seller and the obligor under the receivables contract?

(a) If the parties to a contract are persons resident in India and the contract is not relating to a cross-border transaction, the contract cannot be governed by a foreign law and Indian law would apply by default.

(b) In the case of a cross-border contract, the parties to the contract are at liberty to choose the law of the jurisdiction in which either of the parties to the contract reside. In case they are unable to select either of the laws then the parties can select any neutral law if such law is more commercially developed and is commonly used in similar transactions.

However, in both cases (a) and (b), if the governing law of the contract is a foreign law and it is sought to be enforced in India, Indian courts will refuse to enforce the contract if the obligation sought to be enforced in India is contrary to Indian law or contrary

to public policy. Cross-border assignments of receivables would be required to be in compliance of the FEMA.

For example: the governing law with respect to a contract relating to an immovable property in India cannot be a foreign law.

### 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in India?

No, India has not ratified the United Nations Convention on the International Sale of Goods.

## 3 Choice of Law - Receivables Purchase Agreement

### 3.1 Base Case. Does the Indian law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Indian laws or foreign laws)?

No, there is no legal requirement that the law governing the underlying transactions should also be the law governing the assignment.

However, if the same law governs both the contracts, it would reduce the complications that may arise on account of contradictions or conflicts of law situations, if any, between the two different governing laws.

### 3.2 Example 1: If (a) the seller and the obligor are located in India, (b) the receivable is governed by Indian law, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of India to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Indian law, will a court in India recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

There are certain restrictions under the Foreign Exchange flow in and out of India. Where such receivables arise out of the loans advanced by the seller, the sale in favour of a non-resident will not be allowed unless a specific permission is first obtained from the Reserve Bank of India. Also where the receivables are trade receivables, the same will have to be compliant with the Factoring Act, 2011. Cross-border securitisation/assignments in favour of non-residents would require an approval under FEMA/permission from the Reserve Bank of India.

### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside India, will a court in India recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the requirements of the obligor's country or the purchaser's country (or both) be taken into account?

Yes, the Indian courts should recognise the sale. The laws applicable to the obligor are only with respect to the obligations of the obligor. With respect to a foreign purchaser, if the sale is to be enforced in India against the seller in India, the Indian courts would enforce the sale, unless the performance of the obligations has become illegal under

Indian law. As mentioned above, the sale to a non-resident would have to be made with the permission of the Reserve Bank of India or should be carried out under the Factoring Act, 2011.

**3.4 Example 3: If (a) the seller is located in India but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in India recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with India's own sale requirements?**

No, for the sale to be effective against the seller the sale will have to be enforceable under, and in compliance with, Indian law.

**3.5 Example 4: If (a) the obligor is located in India but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in India recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with India's own sale requirements?**

The sale will have to be in compliance with the Foreign Exchange Regulations as applicable at the time of the sale and also in compliance with all applicable Indian laws.

**3.6 Example 5: If (a) the seller is located in India (irrespective of the obligor's location), (b) the receivable is governed by the law of India, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in India recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in India and any third party creditor or insolvency administrator of any such obligor)?**

(a) If the obligor is located in India, the obligor will be required to comply with Indian law. Also, the transaction that is entered into by the obligor will have to be in accordance with Indian law for it to be enforceable against the obligor in India.

(b) Since the receivables are arising in the seller's country it is normal that the receivables are governed under the law of the seller's country.

(c) Choice of a foreign law as the governing law in an international contract is respected and accepted by the Indian courts and in this case, since the law selected is the law of the jurisdiction where one of the parties to the contract resides, the choice will be respected by the Indian courts. However, if the assignment pertains to a financial debt, it will be necessary for the assignment to be in compliance with guidelines issued for RBI.

(d) Also, in order for the contract to be enforceable under Indian law, the contract cannot be against the Indian law or Indian public policy.

## 4 Asset Sales

**4.1 Sale Methods Generally. In India what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

In India, a sale of receivables is generally referred to as an assignment of receivables and in cases where there are multiple buyers and the sale is routed through a trust, which is used as a special purpose vehicle to effect the transfer, the transaction is called a "securitisation". In an assignment transaction it is customary to execute a Deed of Assignment and related documents.

A sale of an account receivable is ordinarily made under a bilateral document structured in the form of a deed of assignment and not as a purchase of receivables. Under the deed of assignment all rights and benefits arising under the underlying transaction are assigned in favour of the assignee.

There is no legal requirement for the obligor to be a party to the assignment because, under Indian law, rights arising under a contract can be assigned without the consent of the obligor unless the contract specifically provides that a prior permission of the debtor should be obtained.

However, in order for the sale/assignment to be binding on the debtor/obligor, it is advisable to give notice of a sale to the debtor, because without such notice, the underlying debtor/obligor would be validly discharged by making payments to the assignor. However, if a notice of the assignment/sale is issued by the creditor/assignor to the debtor/obligor payments made to such creditor/assignor would not amount to a valid discharge of the obligations of the debtor/obligor.

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

The formalities generally are:

The seller and the purchaser enter into an agreement to assign with conditions precedent on the satisfaction of which the sale takes place. In order that the sale is not challenged at a later date, most sale agreements are made in writing. It would be necessary to pay the stamp duty on the agreement before it is signed if the same is signed in India.

Stamp duty is required to be paid on the deed of assignment, before it is executed. The stamp duty on a deed of assignment varies from state to state ranging from 3 per cent to 10 per cent depending upon the amount of the receivables assigned, and the amount of stamp duty has been remitted to an amount of Rs.100,000 (one hundred thousand Rupees) in most states.

In the states of Maharashtra, Gujarat, Delhi, West Bengal, Karnataka, Rajasthan, and a few other states, notifications have also been issued which have substantially reduced the applicable stamp duties. For example: the stamp duty on a deed of assignment of receivables along with the underlying securities is payable at the rate of 0.1 per cent of the amount of receivables assigned, subject to a maximum of Rs.100,000 (one hundred thousand Rupees) in the state of Maharashtra. The stamp duty varies from state to state so it is ideal that, before a transaction is entered into, the rates are checked with the local sources.

If the seller is a corporate, then the purchaser will have to ensure that the purchase of the receivables is made free from any charge created by the seller in favour of any financier. The seller, in that case, will have to modify the charge if any is recorded over the receivables in the records of the Registrar of Companies. Where the proposed assignment also pertains to transfer, the underlying security, which is in the form of a mortgage on an immovable property, a deed of modification will have to be registered with the Sub-Registrar of the relevant land registry, within whose territorial jurisdiction the immovable property is situated. This modification will be made pursuant to a deed of modification, listing the receivables excluded from the charge.

Under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("SARFAESI Act") secured creditors as defined under section 2(1)(zd) of the SARFAESI Act can perfect their sale, and register the transfers with the CERSAI. The secured creditors, as defined, include the following:

- (a) Banks.
- (b) Financial Institutions.
- (c) Debenture Trustees appointed by any bank or financial institution.
- (d) A securitisation company or reconstruction company.
- (e) Any other trustee holding securities on behalf of a bank or financial institution.

In addition to the above, care should be taken to ensure that:

- (1) the documents are properly executed and witnessed;
- (2) in case of a company, (a) the common seal should be affixed if so required by its Articles of Association, and (b) a Board resolution should be duly and validly passed authorising the sale/purchase; and
- (3) the purchaser should insist on a certificate from a director certifying that the receivables are not encumbered/charged or sold to any other person.

---

#### 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

---

The sale of a promissory note is to be effected by endorsement on the reverse of the promissory note by the person in whose favour the promissory note is issued. If a person, who is a holder in due course, is selling the promissory note (i.e. the person who acquired the promissory note for a valuable consideration) that person also has to endorse the same in the name of the purchaser. Noting may also be carried out where found necessary.

For additional information on perfection, please refer to the answer to question 4.2 above.

---

#### 4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

---

(i) If the contract between the seller and the debtor does not require the consent of the debtor to sell the receivables, the assignor does not need to obtain consent from the obligor.

(ii) Further, under Indian law:

- (a) All rights and benefits arising under a contract are assignable unless the contract specifically prohibits assignment.
- (b) If the contract prohibits the transfer or assignment of a receivable under the contract, the seller cannot assign the receivable.

Since the assignor does not need the consent of the obligor for such assignment, in case the assignor becomes insolvent after the assignment, the sale would still be valid and there is no limitation, which would require the purchaser/assignee to notify the obligor.

The risk of not giving notice is that the obligor would be validly discharged if he made payment to the assignor. Further, if the obligor is not informed about the assignment, and if the assignee undergoes liquidation, the obligor can continue to make payments to the liquidator of the assignor and would still get a valid discharge for its payment obligation.

---

#### 4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

---

There is no prescribed format for the notice, but it should ideally include the following:

- (a) Information that the debt has been assigned.
- (b) The date of the assignment or the date from when such assignment is effective.
- (c) The name of the assignor and the assignee.
- (d) Limitations to the assignment, if any.

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?**

Yes. It is most likely that such restriction is present in the underlying obligor contract. A specific and express prohibition in the contract would affect the Purchaser's right to further assign the contract. Please also see the answer to question 4.7 below.

**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in India? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If India recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

(a) Yes, restrictions from assignment are enforceable. However, there generally cannot be a prohibition on any person from assigning the benefits arising under a contract unless such restriction is reasonable or due to a consideration.

(b) There is an exception with respect to contracts which relate to the performance of personal service, e.g., acting or theatrical performances, etc.

(c) If, in spite of a restriction on assignment, the seller still assigns the contract, the assignment may be treated as invalid at the option of the obligor. The obligor in such situation can refuse to recognise the assignee and continue to perform its obligations towards the assignor.

However, where one party is supposed to receive payments from another party, the receiver can always nominate a third party to receive the payments. If no notice of assignment is given, the payor/obligor can make payments to the original payee under the contract and the obligor will get full discharge upon such payment.

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

(a) Yes, without identifying the receivables, the sale will not be complete and would be vague and, therefore, unenforceable.

(b) The specific information, such as the name (and, if possible, the address of the debtor), the amount of the debt, particulars of the invoice/document giving rise to the debt, the date of invoice/document, payment date, invoice number, etc., will have to be given.

(c) Yes, it would be desirable to have objective characteristics mentioned as it would only help to identify the receivables.

(d) Even in cases where all receivables are being sold, it would be preferable that particulars of the receivables being sold are mentioned because it would help in their identification and to distinguish the receivables which were sold. The list of receivables for an entity actively involved in trading activities changes from day to day and, therefore, it is all the more necessary to identify the receivables which are sold. Moreover, in cases of disputes on account of multiple claimants for the same set of receivables, if the assignment documents provide identification, it helps in proving the ownership.

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

The court will examine the actual intent if the sale is contested.

The mere act of the parties in denominating a transaction as a sale or conveying their intent to sell receivables would not render it to be a true sale, or allow the receivables to be transferred from their books to any other person. The sale will have to meet all the requirements for true sale as prescribed by law and the court would enquire into all economic characteristics to determine whether or not it was a true sale. However, the court would not generally *suo moto* examine such issues until a dispute is raised before it.

In order for the sale to be a true sale, where either the buyer or the seller (or both) is/are a bank/s, non-banking finance companies/housing finance companies the Guidelines issued by the bank for the transfer of assets through securitisation and direct assignment of cash flows should be followed. All rights and interest in the receivables will have to pass to the purchaser. If the sale is to be construed as a true sale, it has to be without recourse to the seller. The seller cannot retain credit risk or interest rate risk or retain any benefits either. The seller can, however, as a collection and paying agent or a servicer, participate in the collection of receivables without jeopardising the perfection of the sale.

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

While the parties can enter into an agreement to sell as and when the receivables come into existence, the actual assignment can only take place after the receivables come into existence. Hence, if the assignor goes into insolvency after entering into a future contract for sale, the same cannot be enforced. Such a contract for the sale of future receivables will not be bankruptcy remote (i.e. it cannot be enforced in case of the insolvency of the seller), which is one of the essential characteristics for a true sale.

**4.11 Future Receivables.** Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

The seller will have to enter into an Agreement for Sale of Receivables. The actual transfer/assignment will take place on the realisation of the receivables, and the seller can give an irrevocable undertaking and power to the assignee to execute the assignment.

**4.12 Related Security.** Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Assignments can be validly entered into so as to include the assignment of the underlying security interest.

The types of transaction which pose a difficulty are the assignments of mortgage loan receivables where the underlying security is an immovable property. This is because every transfer of an immovable property requires mandatory requirement of registration before the office of the Sub-Registrar of Assurances and such transfer also attracts a heavy stamp duty. The common method therefore prevailing in the Indian market is to transfer only the receivables, and to allow the assignor to continue to hold the mortgage security for, and on behalf of, the purchaser.

**4.13 Set-Off; Liability to Obligor.** Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?

The obligor’s rights are as contained in the obligor’s contract with the assignor. None of those rights can be modified or terminated by the sale of receivables contract. The purchaser or the seller will be responsible for damages only if they acted beyond the rights available to them under the law.

## 5 Security Issues

**5.1 Back-up Security.** Is it customary in India to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

What we find commonly is a credit enhancement which is generally in the range of 10 per cent to 20 per cent of the total pool size in the form of:

- (i) cash collateral in the form of fixed deposits retained with a bank with a lien marked in favour of the assignee;
- (ii) bank guarantees; and

- (iii) corporate undertakings.

These are credit supports to be used in case of default by the obligors. We have yet to see a back-up security to safeguard a non-perfected sale.

**5.2 Seller Security.** If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of India, and for such security interest to be perfected?

See the answers to sections 3 and 4 above.

**5.3 Purchaser Security.** If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in India to grant and perfect a security interest in purchased receivables governed by the laws of India and the related security?

The question of the purchaser granting a security interest in the receivables does not arise because the purchaser, upon the purchase of said receivables, becomes the full owner and has no obligation to the seller.

**5.4 Recognition.** If the purchaser grants a security interest in receivables governed by the laws of India, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in India or must additional steps be taken in India?

See question 5.3 above.

**5.5 Additional Formalities.** What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

While the documents for assignment would be similar in all cases, the requirements would differ on account of a difference in the nature of security interest that is proposed to be transferred in favour of the purchaser/assignee.

If the assignment document relates to a “mortgage interest”, and if the underlying mortgage is also being transferred, then it will have to be registered with the Sub-Registrar of Assurances within whose jurisdiction the immovable property is situated and the registration fee shall also be paid as applicable in the place where the security document is registered. This is in addition to the registration of security interest created under the security document registered with the Registrar of Companies in a case where the security interest is created by a company. However, as explained earlier, if a pool of receivables is being assigned, the common practice is to allow the seller to continue to hold and retain the security interest for, and on behalf of, the purchaser and if the underlying security interest is not being conveyed under the Deed of Assignment, it needs not be registered.

Since the commencement of the operations of the CERSAI, it is necessary to have the sale registered with CERSAI if the seller is a bank or an institution, which qualifies for such registration.

With respect to the assignment of a consumer loan, the underlying security in the form of motor vehicles, insurance policies, debt securities, is generally held in trust for the assignee by the assignor and the assignment documents do not convey the underlying security.

- 5.6 Trusts. Does India recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Indian law does recognise trusts and accepts a trust arrangement. Once the sale of receivables is complete, the sold receivables, upon collection and before transmission to the purchaser, will be deemed to be held in trust by the seller. However, the document of assignment should have this as one of the covenants by the collection and paying agent/servicer and the assignor.

- 5.7 Bank Accounts. Does India recognise escrow accounts? Can security be taken over a bank account located in India? If so, what is the typical method? Would courts in India recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in India?**

Yes, escrow accounts are legally recognised in India and amounts lying in bank accounts can be held for, and on behalf of, another entity and such accounts can be regarded as bankruptcy remote provided a charge or lien is marked thereon and the bank with whom such account is opened has taken note of such charge. However, such charge will have to be registered with the Registrar of Companies and agreed to in writing.

Yes, the grant of a charge over movable assets of a company can be created in favour of a non-resident company's obligations in favour of a non-resident creditor.

However, since inflow and outflow of exchange in and out of India is regulated to some extent, if a debt is obtained by an Indian company from a foreign lender it will have to be subject to the external commercial borrowings guidelines. The Reserve Bank of India has also made regulations with respect to the issuance of debentures outside India and the nature of securities that can be created for the same.

- 5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

A security over a bank account is possible by the creation of a lien over the account. Where the banker recognises a lien, no transfer out of such lien marked account by the account holder is possible without the consent of the lien holder/secured party. This would be the case for all funds, and would include future deposits into the account until the lien is removed.

- 5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

No, not without the consent of the secured party.

## 6 Insolvency Laws

- 6.1 Stay of Action. (a) If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will India's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? (b) Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? (c) Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

(a) No. If the sale of the receivable is perfected, it will be bankruptcy remote and the purchaser will be entitled to collect, transfer or otherwise exercise ownership over the purchased receivables.

(b) The liquidator, in the case of a company, or the receiver or an official assignee, in the case of an individual, is not legally entitled to order or maintain any other action preventing the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables.

(c) If the purchaser is deemed to be a secured party instead of the owner, the secured party can proceed for enforcement of security upon occurrence of an event of default. Alternatively, it would be required to wait in queue before the official liquidator appointed by the Company Court during the liquidation of the company to receive any amounts due, for the distribution before the Company Court hearing the winding up.

- 6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

If the transfer of a receivable is a fraudulent preference or a voidable transfer discussed hereinafter, the liquidator will have to make an application to set aside a voidable transfer or fraudulent preference. In such a case the liquidator can also make an interim application for a stay of payments by the debtor to the purchaser.

- 6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in India for (a) transactions between unrelated parties, and (b) transactions between related parties?**

If the transaction involved a fraudulent transfer, i.e., being a transfer made with an intention to avoid payment to a legitimate creditor the sale would be set aside by the liquidator.

- 6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

The assets of the purchaser purchased from the seller can be consolidated with those of the seller or its affiliates in the

insolvency proceedings only if the receivables fall within the doctrine of fraudulent preference of voidable transfer referred to above.

Also in cases of securitisation, if the documentation for the sale of receivables is defective and does not satisfy the “true sale” criteria prescribed under the guidelines issued by the RBI, the receivables can be added back to the books of the seller for the purposes of computation of the assets of the seller. However, assets of the purchaser cannot be consolidated with assets of the seller.

---

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in India, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

---

The sale of receivables which were not in existence at the time when the sale was made, such as receivables for the services to be rendered or receivables for goods to be sold in future, can be challenged because it is dependent on performance by the seller, which may not be possible after the liquidation of the seller and, therefore, would not be bankruptcy remote and would vitiate true sale.

---

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

---

The debtor in such a case is liable only to the extent of the recourse. He cannot be declared to be insolvent, if he fails to pay anything over and above the liability undertaken by him. However, the debtor will be liable up to the extent of the recourse that was agreed and failure to meet such amount can lead to the debtor being declared insolvent.

## 7 Special Rules

---

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in India establishing a legal framework for securitisation transactions? If so, what are the basics?**

---

Yes. The government of India enacted the Securitisation Act, namely, the Securitisation & Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002 (Securitisation Act). Chapter II of the Act, which is most relevant for us, deals with securitisation.

Basic concepts:

The Securitisation Act deals with the acquisition of financial assets (receivables) by a securitisation company (to be incorporated with the prescribed level of capital) and also deals with enforcement of security by secured creditors. The Securitisation Act provides for the acquisition and can also take place by entering into an agreement for the transfer of the financial assets on terms and conditions agreed between the parties. However, the Act does not specify the mode of assignment of the financial asset to the securitisation company.

The Securitisation Act confers power on the Reserve Bank of India to determine policy and formulate guidelines with respect to

securitisation. Any dispute arising between any of the parties to a securitisation transaction are to be settled by arbitration or conciliation as per the provisions of the Arbitration and Conciliation Act, 1996.

The Reserve Bank of India has issued Guidelines to be followed by banks and non-banking finance companies in order to qualify the transaction as a true sale. The main features of the Guidelines include the following:

- (i) True sale: To enable the transferred assets to be removed from the balance sheet of the originator in a securitisation structure, the isolation of assets or ‘true sale’ from the originator/seller to the SPV/buyer is an essential prerequisite. Once this is done, the originator/seller (if a bank or a company registered with the Reserve Bank as a non-banking finance company) will not be required to maintain any capital against the value of assets so transferred from the date of such transfer. The Guidelines prescribed a minimum holding period and a minimum retention requirement by the seller in order for the transaction to qualify as a “true sale” under the Guidelines.
- (ii) The guidelines provide various criteria that have to be satisfied to meet a true sale including the requirement that the transaction should be bankruptcy remote.
- (iii) SPV: This is dealt with under question 7.2.
- (iv) The Guidelines also prescribe the levels and forms of credit enhancements.
- (v) Credit enhancement in the form of credit support provided to an SPV to cover the losses on account of default in payments arising in the pool of assets. The Guidelines provide that such facilities can be provided either by the originator and/or third parties.
- (vi) The RBI Guidelines also provide for the representations that the seller is required to make.

---

**7.2 Securitisation Entities. Does India have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

---

Yes. The SARFAESI Act has been specifically enacted to encourage the establishment and regulation of securitisation entities.

The requirements to establish a securitisation company are as follows:

**Financial**

The securitisation company has to be capitalised up to the limit prescribed under the Act.

The RBI has to be satisfied that the securitisation company has not incurred losses in any of the three preceding financial years and the securitisation company is required to make adequate arrangements for the realisation of the financial assets acquired for securitisation and shall be able to pay periodical returns and redeem on the respective due dates on the investments made in the securitisation company by qualified institutional buyers.

**Directors**

The RBI may require that the directors of the securitisation company have adequate professional experience in matters related to finance, securitisation and reconstruction. The directors nominated by a sponsor or in any way related with the sponsor or its subsidiaries cannot be more than 50 per cent of the total members of the Board of Directors. The directors shall have been convicted of any offence involving moral turpitude.



**Sponsor**

The sponsor cannot be a holding company of another securitisation company or otherwise hold any controlling interest in the securitisation company.

**Other conditions**

(a) Apart from the above, it is also required that the securitisation company complies with the prudential norms specified by RBI.

(b) Yes. There are prescribed attributes and benefits of the company which, *inter alia*, include the following:

As per the guidelines, the SPV is required to be a bankruptcy remote and non-discretionary structure so as to ensure the passing on of the receivables without any hindrances.

The originator does not have a right to exercise any control, either directly or indirectly, over the SPV and the trustees, and shall not settle the trust deed.

In order to protect their interests, investors are empowered in the trust deed to change the trustee of the SPV at any point of time.

A securitisation company is allowed to perform several other functions provided that performance of these functions by the securitisation company does not give rise to any pecuniary liability on the securitisation company.

(c) Yes. These have been discussed under the requirements for registration as a securitisation company under part (a) of this question.

**7.3 Limited-Recourse Clause. Will a court in India give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

Indian courts would respect the right of parties to select the law governing their contract and would be guided by principles of private international law in arriving at a decision on the validity of such selection. However, such limited recourse assignment would not qualify as a "true sale" under Indian law.

**7.4 Non-Petition Clause. Will a court in India give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

Indian courts will give effect to a contractual provision so long as it is not in violation of Indian law.

**7.5 Priority of Payments "Waterfall". Will a court in India give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

Yes, however a statutory claimant (*viz.* the tax, stamp duty, etc.) will always enjoy priority irrespective of the law governing the agreement. If the company is undergoing liquidation or is facing winding proceedings there are prescribed priorities under the law.

**7.6 Independent Director. Will a court in India give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

Yes, so long as such provision does not conflict with Indian laws, it would be given effect to by the Indian courts.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in India, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in India? Does the answer to the preceding question change if the purchaser does business with other sellers in India?**

If such acquisition is a regular business then it will be necessary to obtain a licence to operate as a non-banking finance company in India. Only a qualified institutional buyer i.e. a financial institution, insurance company, bank, state financial corporation, state industrial development corporation, trustee or securitisation company or a reconstruction company, registered under the Securitisation Act or an asset management company of a mutual fund or a foreign institutional investor are entitled to purchase security receipts issued by a securitisation company.

The position is the same even if the purchaser deals with other sellers.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

The servicer does not require a licence but has to be conferred with such rights under a duly signed agreement. However, if receivables arise from a loan transaction, the seller should have had the licence when the loans were given.

**8.3 Data Protection. Does India have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

Bankers are subject to a requirement to maintain confidentiality with respect to their customers. Further, in some cases there may be a requirement for such obligations for confidentiality even in contracts and the parties to the contract will be bound by the same.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law in India? Briefly, what is required?**

Yes, because upon the assignment/sale the purchaser would be bound by the obligations arising under the contract with the

obligors. If the purchaser is a bank and is trading in consumer receivables, the consumer protection law will apply to the purchaser in its capacity as the assignee of the rights and obligations of the assignor.

---

**8.5 Currency Restrictions. Does India have laws restricting the exchange of Indian currency for other currencies or the making of payments in Indian currency to persons outside the country?**

---

Yes. Inflow and outflow of exchange is strictly regulated in India. The law governing foreign exchange transactions is the Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder ('FEMA'), which restricts not only exchange of Indian Rupees for other currencies but also payments in Indian currency to persons resident outside India.

## 9 Taxation

---

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in India? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

---

If the receivables consist of an interest element, then the question of withholding tax would arise. However, if the payment is of a principal amount such as a hire purchase instalment or repayment of loan instalments, there will not be any withholding tax.

Deferred consideration would disqualify the transaction from being treated as a "true sale" under Indian law.

---

**9.2 Seller Tax Accounting. Does India require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

---

No specific accounting policies have, so far, been prescribed for tax purposes, whether by the purchaser or the seller in the context of securitisation. Accounts are to be prepared as per Indian generally accepted accounting principles.

---

**9.3 Stamp Duty, etc. Does India impose stamp duty or other documentary taxes on sales of receivables?**

---

Yes, in India, as per Indian law, there is a stamp duty implication on transactions.

Stamp duty is also payable on every securitisation/assignment document.

---

**9.4 Value Added Taxes. Does India impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

---

No. There is no value added tax but there is service tax on any services offered for consideration.

---

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

---

Yes, if the seller avoids paying taxes arising on account of the sale of assets, and the assignor fails to pay the taxes as and when due, the obligation would then flow to the assignee/purchaser.

The stamp authorities will recover stamp duties from any of the parties, if the stamp duty is not paid on a document. Accordingly, the stamp duty authorities will be able to make a claim against the purchaser for stamp duty payable on assignment of receivables or collection for unpaid tax.

---

**9.6 Doing Business. Assuming that the purchaser conducts no other business in India, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in India?**

---

The purchaser will be taxed for its income in India. Also, if it conducts its business on a regular course of activities in India, whether through an agent or otherwise, the purchaser will be liable to pay tax on income, if any, arising from the sale/resale of the receivables or on the differential amount between the amount paid for purchase of the receivables or the amount of the receivables actually received by it. Whether such tax will be as applicable on a business income or on capital gains will depend on the nature of the business of the purchaser.



### Mona Bhide

Dave & Girish & Co.  
1st Floor, Sethna Building  
55 Maharshi Karve Road  
Marine Lines, Mumbai 400002  
India

Tel: +91 22 2206 2132/92  
Fax: +91 22 2208 5620  
Email: [mona@davegirish.com](mailto:mona@davegirish.com)  
URL: [www.davegirish.com](http://www.davegirish.com)

Mona Bhide joined Dave & Girish & Co. in 1985 and since then has been working with the firm. She is currently the Managing Partner of Dave & Girish & Co. She has completed a B.Com. and LL.B. Degree from Mumbai University and has also graduated with a Masters Degree from Northwestern University, School of Law, Chicago. She has worked with the American Bar Association, as well as a law firm in Chicago before she returned to Dave & Girish & Co., in 2002. She handles structured finance, derivatives, banking, cross-border financing, corporate law, and securities and investment documentation, IPOs, GDRs/ADRs and private equity transactions.

— **DAVE & GIRISH & CO.** —  
Advocates

Dave & Girish & Co. was founded in the year 1978 and is a pioneer in the field of banking and securitisation. The firm has offices in Mumbai and Bangalore and associate offices in Delhi and Hyderabad. Dave and Girish is known for its cross-border banking, international finance, and corporate law practices. Dave & Girish & Co. was the first law firm to have become a member of the International Swaps and Derivatives Association and it was also the first firm to document a securitisation transaction in India. It is highly regarded in the field of structured finance and derivative and is known for its skills on drafting and documenting and negotiating intricate financing documentation. The firm represents multinational banks and major corporate groups in India.

The firm was started by the Late Mohanlal Dave and is currently headed by Mr. Girish Dave who is a luminary in the field of banking and corporate law. His latest transactions include an offshore syndicated loan and a Japanese Bond Issue.

# Indonesia



Freddy Karyadi



Novario Asca Hutagalung

Ali Budiardjo, Nugroho, Reksodiputro

## 1 Receivables Contracts

**1.1 Formalities.** In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

Generally, agreements in Indonesia can be made either in writing or orally. However, for a debt that arises from a loan agreement, article 1756 of the Indonesian Civil Code (“ICC”) stipulates that the payment of a debt shall only be limited to the amount stated in the agreement. Thus, receivables shall be made in an agreement in order to provide clarity. Further, pursuant to Article 1457 of the ICC, a sale and purchase is an agreement where one party binds itself to provide goods and the other party pays the agreed price. Article 1513 of the Indonesian Civil Code further stipulates that the main obligation of the buyer is to pay the purchase price in the place, and at the time agreed, in the agreement. If there is no agreement on the place and time of payment, Article 1514 of the Indonesian Civil Code further regulates that the buyer has to pay at the time of the levering. Based on this, it can be concluded that for the sales and purchase, the payment of the good/services has to be made at the agreed time or at the time of the levering. Such payment cannot be made in instalment since it has to be paid at the levering.

Invoices alone are sufficient to be deemed as a binding agreement, as long as the recipient of the invoices has made the payment to the issuer of the invoice. Hence, the recipient of the invoices is deemed to provide his consent to the invoices. Indonesian law also recognises the concept of consent by conduct under Article 1347 of the ICC which stipulates that customary stipulation shall be deemed to be implied in the agreement, notwithstanding that these have not been expressed.

As previously explained, a receivables contract the nature of which can be deemed as a debt or loan agreement shall be made based on a binding agreement. Hence, it cannot be deemed to exist as a result of the behaviour of the parties. However, as for other agreements which entitle the seller to receive payment aside of the loan agreement, we believe that a contract might be deemed to exist as a result of the behaviour of the parties (please also refer to our explanation above in relation to Article 1347 of the ICC).

**1.2 Consumer Protections.** Do Indonesia’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

Generally, there are no restrictions on interest on consumer credit, loans or other kind of receivables. Parties may determine the interest rate mutually. However note that, in Indonesia a usury law (the “*Woekerordonantie*”) is still in force. In addition, save for a credit card, Bank Indonesia limits the interest to a maximum of 2.95 per cent per month.

There is no statutory interest rate on late payments.

There are no noteworthy rights of consumers under the Consumer Protection Law with respect to the receivables that they owe.

**1.3 Government Receivables.** Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Yes, additional requirements may apply to the sale or collection of government’s assets. Article 46 of Law No. 1 of 2004 on State Treasury stipulates that any transfer of a government’s asset other than land and buildings, shall obtain approval from the House of Representatives, the president, or the minister of finance. Such approval is determined based on the value of the asset. As for the government’s asset other than land and buildings valued (i) more than Rp100 billion shall obtain approval from the House of Representatives, (ii) Rp10 billion up to Rp100 billion shall obtain approval from the president, and (iii) below Rp10 billion shall obtain approval from the minister of finance.

## 2 Choice of Law - Receivables Contracts

**2.1 No Law Specified.** If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Indonesia that will determine the governing law of the contract?

Indonesia acknowledges the concept of “the most characteristic connection” in order to determine the governing law of a contract that not stipulates a choice of law provision.

**2.2 Base Case.** If the seller and the obligor are both resident in Indonesia, and the transactions giving rise to the receivables and the payment of the receivables take place in Indonesia, and the seller and the obligor choose the law of Indonesia to govern the receivables contract, is there any reason why a court in Indonesia would not give effect to their choice of law?

No, there is not.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor.** If the seller is resident in Indonesia but the obligor is not, or if the obligor is resident in Indonesia but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Indonesia give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Generally, an Indonesian court will recognise the parties' choice of law in an agreement. However, to the extent there is an Indonesian party, an Indonesian court has the right to cancel the agreement if it is deemed to violate Indonesian law.

**2.4 CISG.** Is the United Nations Convention on the International Sale of Goods in effect in Indonesia?

No, it is not.

### 3 Choice of Law - Receivables Purchase Agreement

**3.1 Base Case.** Does Indonesian law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Indonesia's laws or foreign laws)?

No, it does not.

**3.2 Example 1:** If (a) the seller and the obligor are located in Indonesia, (b) the receivable is governed by the law of Indonesia, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Indonesia to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Indonesia, will a court in Indonesia recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Generally, an agreement must fulfil the requirements under Article 1320 of the ICC to be deemed valid, of which the requirements are as follows:

1. there must be consent of the individuals who are bound thereby;
2. there must be capacity to conclude an agreement;
3. there must be a specific subject; and
4. there must be an admissible cause.

However, in relation to the transfer of receivables, the following requirements must be made in order to give effect to such transfer: (i)

there is an underlying agreement to the sale and purchase; (ii) there is a delivery of the object, in the form of deed of transfer/assignment from the seller to the purchaser; and (iii) there is notice and acknowledgment of the obligor to such transfer of receivables.

**3.3 Example 2:** Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Indonesia, will a court in Indonesia recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

See the answer to question 3.2. An Indonesian court should uphold the choice of Indonesian law by the parties.

**3.4 Example 3:** If (a) the seller is located in Indonesia but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Indonesia recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Indonesia's own sale requirements?

Yes. Indonesian law recognises the concept of freedom of contract, of which the Indonesian party may freely enter into a contract to the extent is not violating public order. Therefore, if the nexus of the agreement is valid, the court might acknowledge the perfection of the sale and purchase as regulated by the requirement under the prevailing laws of the chosen governing law.

**3.5 Example 4:** If (a) the obligor is located in Indonesia but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Indonesia recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Indonesia's own sale requirements?

Yes. See the answer to question 3.4 above.

**3.6 Example 5:** If (a) the seller is located in Indonesia (irrespective of the obligor's location), (b) the receivable is governed by the law of Indonesia, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Indonesia recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Indonesia and any third party creditor or insolvency administrator of any such obligor)?

Yes. See the answer to question 3.4 above.

## 4 Asset Sales

- 4.1 Sale Methods Generally.** In Indonesia what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

The seller and the purchaser will enter into a sale and purchase agreement. The customary terminology for a sale of receivables is “a true sale”.

- 4.2 Perfection Generally.** What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

Please refer to our explanation to question 3.2 above.

- 4.3 Perfection for Promissory Notes, etc.** What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

### Promissory notes

The sales of a promissory note can only be perfected by way of endorsement.

### Mortgage loans

A loan secured by a mortgage may be sold in the form of a sale and purchase agreement or an assignment agreement.

### Consumer loans

A transfer of a consumer loan can be made in the form of a sale and purchase agreement.

### Marketable debt securities

Marketable debt securities (MDS) (which are issued in scripless form), must be transferred from the securities account of the seller to the securities account of the purchaser to be perfected. On the other hand, as for MDS issued in physical form, the perfection shall be made by way of endorsement upon physical delivery.

- 4.4 Obligor Notification or Consent.** Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

First, it must be referred to an assignment provision as regulated under the underlying agreement of the receivables. If the consent of the obligor is required under such assignment clause, then the consent of the obligor is required to perfect the sale of the receivables. However, if the agreement is silent then Article 613 of ICC shall prevail; the article stipulates that assignment or transfer of receivables should be notified to the debtor or agreed and acknowledged in writing by the debtor.

- 4.5 Notice Mechanics.** If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There is no requirement of notice regarding the time or how it must be delivered. However, in order to perfect the sale of receivables the obligor shall be informed promptly that a sale of receivables has taken place.

As for an insolvency proceeding and execution of security, notice to the obligors is provided by the bailiff.

- 4.6 Restrictions on Assignment - General Interpretation.** Will a restriction in a receivables contract to the effect that “None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]” be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says “This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]” (i.e., the restriction does not refer to rights or obligations)?

Yes, both provisions can be interpreted to mean that for the transfer of obligations prior consent from the obligor shall be obtained.

- 4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Indonesia? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Indonesia recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Since Indonesia honours the freedom of contract, such restrictions will be acknowledged and enforceable in Indonesia (since it has been agreed by the parties to the contract).

If the seller sells the receivables to the purchaser without any consent from the obligor (not in compliance with the provisions under the contract), the seller shall be liable to the obligor for breach of contract.

- 4.8 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells *all* of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

Article 1320 paragraph 3 of the ICC stipulates that an agreement

must set out a specific object. Nonetheless, there is no provision or guidance regarding the details of receivables.

However, we believe that the details should include (i) the name of obligor, (ii) the amount of the receivables, (iii) the underlying agreement of the receivables mentioning the parties, the date of agreement and the number of the agreement (if any), (iv) the payment date, and (v) other specific information, in order to distinguish each of the receivables. This will also apply if the seller sells all of his receivables. The seller should detail all the receivables being sold.

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

As previously explained, Indonesian law recognises the concept of “freedom of contract”. Hence, if the agreement has been duly signed and there are no outstanding conditions that need to be fulfilled, and such agreement has complied with Article 1320 of the ICC, the agreement is binding on the parties to such agreement.

However, for a more sophisticated transaction (i.e. REPO), in the event of a dispute, a court may categorise a REPO transaction as a secured loan transaction. Therefore, the seller may retain a credit risk and a right of repurchase/redemption.

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

Yes. However, the notice and acknowledgment by the debtor still remains.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?**

We assume future receivables in this section as the sale of receivables which has not been due at the sale date but will be due in the future. Since there are requirements to: (i) execute a deed of transfer/assignment from the seller to the purchaser; and (ii) provide notice for the acknowledgment of the obligor to such transfer of receivables, to fully affect the transfer of the receivables, it can be structured where the seller grants a power of attorney to the purchaser to make such deed and to send notice to the obligor once the receivables has become due.

As for the distinction in relation to the insolvency event, please refer to question 6.5 below.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

Practically, security in Indonesia is made in three forms, depending on the type of assets involved.

**Mortgage**

A mortgage is created over an immovable asset. If the receivable is secured by a mortgage and it is transferred, the transferee should register it at the land office and the mortgage certificate should be amended to state the name of the transferee.

**Pledge**

A pledge is a security interest over tangible or intangible property. If the receivable is secured by a pledge and it is transferred, a notification to the pledgor is necessary to be made in favour of the transferee.

**Fiduciary Security**

A fiduciary security is a security right over movable (tangible or intangible) and immovable property which cannot be secured by a mortgage. If a receivable is secured by a fiduciary security and it is transferred, the transferee should register it at the fiduciary registration office.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

In the event a set-off right is not waived in an agreement, such right still remains, and may be executed. As such, a borrower may implement its right to set-off against any amount it owes to the purchaser.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Indonesia to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

It is not common in Indonesia to take a “back-up” security interest, to the extent the sale of receivables and the related security have been perfected.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Indonesia, and for such security interest to be perfected?**

A security interest in receivables in Indonesia is secured under a fiduciary security. Execution of a deed of fiduciary security and registration to the fiduciary registration office is needed in order to perfect the security.

**5.3 Purchaser Security.** If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Indonesia to grant and perfect a security interest in purchased receivables governed by the laws of Indonesia and the related security?

Commonly, receivables are secured under a fiduciary. A fiduciary over receivables should be registered to the fiduciary registration office in order to be perfected.

**5.4 Recognition.** If the purchaser grants a security interest in receivables governed by the laws of Indonesia, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Indonesia or must additional steps be taken in Indonesia?

To the extent the security is located in Indonesia, then it shall be registered and perfected under Indonesian law.

**5.5 Additional Formalities.** What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

#### Insurance policies

Acknowledgment by the insurer is needed in order to perfect a security interest on insurance policies. In addition, a banker's clause can also be an option for a security interest connected to insurance policies.

#### Promissory notes

See the answer to question 4.3 above.

#### Mortgage loans

See the answer to question 4.3 above.

#### Consumer loans

See the answer to question 4.3 above.

#### Marketable debt securities

See the answer to question 4.3 above.

**5.6 Trusts.** Does Indonesia recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?

The concept of trust is not recognised under Indonesian law since Indonesian law does not recognise the concept of splitting up ownership (i.e. between ownership of record and beneficial ownership).

**5.7 Bank Accounts.** Does Indonesia recognise escrow accounts? Can security be taken over a bank account located in Indonesia? If so, what is the typical method? Would courts in Indonesia recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Indonesia?

Yes, escrow accounts are recognised in Indonesia and usually structured under an escrow agreement.

Yes. The typical method of a security over bank account is a pledge. However, the Fiduciary Registration Office has expressed

the view that a bank account cannot be subject to an Indonesian security interest and the enforceability of a pledge over a bank account is yet to be tested in court. Although its enforceability is doubtful, it is common in practice to secure bank account with a pledge over a bank account.

Yes. An Indonesian court should recognise it.

**5.8 Enforcement over Bank Accounts.** If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

See the answer to question 5.7.

In practice, a pledge of a bank account is supplemented with a power of attorney to manage a bank account which grants authorisation to the attorney to manage and control all cash flowing into the bank account. However, note that perfection and enforcement of a pledge of a bank account shall be acknowledged by the bank.

**5.9 Use of Cash Bank Accounts.** If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

In practice, to access or take action with regard to the pledged account, prior consent from the pledgee shall be obtained.

## 6 Insolvency Laws

**6.1 Stay of Action.** If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Indonesia's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

In relation to the sale of receivables under Indonesian law, the sale of receivables will be deemed as valid if it has fulfilled certain aspects. Please refer to our answer to question 3.2 above.

There is a possibility that the sale and purchase has occurred (by the means of sale and purchase agreement of the receivables), the delivery has occurred (by the means of transfer/assignment of the receivables to the purchaser – *cessie*) but the seller has not notified the obligor about such transfer and the obligor has not acknowledged such transfer which leads to the payment of the receivables by the obligor to the seller instead of the purchaser. If this happens and the seller is declared bankrupt, the receiver must refer to stay of action regulation, as regulated under Indonesian Bankruptcy Law ("IBL"). It is regulated that: (a) the right of enforcement of secured creditors; and (b) the rights of any third parties to claim assets that are under the control of the bankrupt debtor or the receiver shall be stayed for a maximum time period of 90 days as of the date of the decision declaring the bankruptcy is rendered. Hence, the payment being made by the obligor to the seller will be considered as the right of any third party, as stated in



point (b) above and therefore will be subjected to a stay period. Other than this possibility, the purchaser should have a legal ownership of the receivables once the agreement for the sale and purchase has been executed by the parties, the delivery has been made, and it has been notified to the obligor.

If the position of the purchaser is as a secured creditor, instead of the purchaser, the IBL regulates an exception to stay of action for such secured creditors whose right is secured by cash deposits and the rights of the creditors to set-off the debts.

---

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

---

Please refer to our response to questions 6.1 and 6.3.

In addition to this, there is also a possibility that the agreement to the sale and purchase has been executed but the *cessie* has not been made and the seller has been declared bankrupt, which means that the legal title of the receivables has not been legally transferred to the purchaser. In this event, the decision on whether the agreement will be continued or not will fall into the discretion of the receivers. If the receivers decide to terminate the agreement, the counterpart may file a claim for damages and shall be treated as an unsecured creditor. However, the IBL regulates that if, before the bankruptcy declaration decision is rendered, the execution for the sale of debtor's assets (movable and/or immovable) has gone too far so that the sale date has been fixed, upon the consent of the supervisory judge, the receivers may proceed with the sale at the expense of the bankruptcy estate.

---

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Indonesia for (a) transactions between unrelated parties, and (b) transactions between related parties?**

---

In Indonesia, fraudulent transfer is regulated under the IBL and the ICC.

The IBL states that only the receiver could request for the nullification of a preferential transfer transaction conducted by the debtor before its bankruptcy if such transaction was considered detrimental to the creditors and met the following requirements:

- the preferential transfer was performed by the debtor before it was declared bankrupt;
- the debtor was not obligated by contract (existing obligation) or by law to perform the preferential transfer;
- the preferential transfer prejudiced the creditors' interests; and
- the debtor and such third party had or should have had knowledge that the preferential transfer would prejudice the creditors' interests.

However, in addition to the above, the ICC provides the right of any creditor to request the nullification of preferential transfer. The ICC stipulates that right exists within a period of five years starting from the date when the creditor knew, or should have known, the preferential transfer prejudiced the creditor's interests. Meanwhile, the IBL stipulates that a legal act taken by the debtor up to one year prior to the issuance of a bankruptcy decision which prejudices the rights of the

creditors (while such legal act is not compulsory to be carried out by the debtor) could be deemed detrimental to the creditors. However, the IBL does not clearly define any time difference on the length for a "suspect" or "preference" period for a transaction entered by related or unrelated parties to the bankrupt debtor.

Notwithstanding the above, please be advised that the ICC and the IBL protect a good faith purchaser from a preferential claim. As such, even if the preferential transfer claim on an asset was accepted and the transaction was nullified, purchasing the asset in good faith should be a valid defence for the purchaser to protect the asset from seizure in relation to a preferential transfer claim made by a receiver or creditor.

---

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

---

We believe that this is not applicable under Indonesian bankruptcy proceedings.

---

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Indonesia, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

---

For the purposes of answering this question, we assume that the commencement of proceedings here means the date when the seller/debtor is declared bankrupt.

**Sales of Receivables that Would Occur after the Commencement of the Proceeding**

After the declaration of bankruptcy status to the debtor, all assets of the debtor will be managed by the receivers and the debtor will not have any access to its assets again. Therefore, we believe that it is unlikely that the sale of receivables will be made after the declaration of bankruptcy status of the debtor.

**Sales of Receivables that only Come into Existence after the Commencement of the Proceeding**

We note that the possible scenario for this case is the sale of receivables which has not been due at the sale date but which will be due in the future but the seller/debtor has been declared bankrupt before the due date of the receivables. Hence, the *cessie* has not been made which means that the legal title of the receivables has not yet been transferred to the purchaser. In this regard, please refer to our answer to question 6.2 as well. In this event, the decision on whether the agreement will be continued or not will fall into the discretion of the receivers. If the receivers decide to terminate the agreement, the counterpart may file a claim for damages and shall be treated as an unsecured creditor.

---

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

---

The IBL regulates that the requirements of a debtor to be declared bankrupt are: (i) having two creditors or more; and (ii) failing to pay at least one debt which has matured and become payable. The IBL

further regulates that the petition for bankruptcy shall be granted if the facts or circumstances summarily prove the fulfilment of the requirement as mentioned above. As such, if the requirements have been fulfilled, we believe that the limited recourse provision should not have any effect on the bankruptcy proceeding. However, this will be subject to the discretion of the panel of judges in the proceeding who might have their own view as the nature of the case.

## 7 Special Rules

### 7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Indonesia establishing a legal framework for securitisation transactions? If so, what are the basics?

Yes. There are several regulations in Indonesia in relation to securitisation transactions. Below are regulations in relation to the securitisation transaction in capital markets and banking.

#### Capital market

In a capital market, below are regulations in relation to the securitisation transaction:

- Capital Market Supervisory Agency (“Bapepam”) Regulation No. IX.K.1 on Guidelines for Asset-backed Securities (“EBA”) Collective Investment Contracts;
- Bapepam Regulation No. V.G.5 on Investment Manager Functions With Regard to EBA;
- Bapepam Regulation No. IX.C.9 on Registration Statements for EBA Public Offerings;
- Bapepam Regulation No. IX.C.10 on Guidelines on the Form and Content of Prospectus for EBA Public Offerings; and
- Bapepam Regulation No. VI.A.2 on Functions of Bank Custodians with regard to EBA.

In Indonesia, EBA is issued under an EBA Collective Investment Contract (“KIK-EBA”). A KIK-EBA is entered by, and between, an investment manager and a custodian bank of which the investment manager will manage the portfolio and the custodian bank will provide custodian services to the investment manager.

Aside from the investment manager and custodian bank, there are other parties involved, for example, a servicer (usually this role is conducted by the initial creditor (originator)) and a credit enhancer.

#### Banking

In banking, regulations relating to securitisation are governed by Bank Indonesia Regulation No. 7/4/PBI/2005 on Prudential Principles in Asset Securitisation for Commercial Banks.

This regulation generally governs criteria and requirements of financial assets that can be transferred in relation to the securitisation asset and function of a bank in securitisation transactions.

#### ICC

Article 584 of the ICC stipulates the following:

*“Ownership of assets cannot be acquired in any manner other than by appropriation, attachment, prescription, legal or testamentary succession, and by delivery pursuant to a transfer of legal title, originating from the individual who was entitled to dispose of the property.”*

Article 613 of the ICC stipulates the following:

*“The transfer of registered debts and other intangible assets, shall be effected by using an authentic or private deed, in which the rights to such objects shall be transferred to another individual. Such transfer shall have no consequences with respect to the debtor, until he has been notified thereof, or if he has accepted the transfer in writing or has acknowledged it.”*

### 7.2 Securitisation Entities. Does Indonesia have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

There is no specific regulation for the establishment of a special purpose entity for securitisation; such establishment will generally comply with the Indonesian Company Law.

### 7.3 Limited-Recourse Clause. Will a court in Indonesia give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

Yes, to the extent there is an Indonesian party or other legal nexus which relates to Indonesia.

### 7.4 Non-Petition Clause. Will a court in Indonesia give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

See the answer to question 7.3 above.

### 7.5 Priority of Payments “Waterfall”. Will a court in Indonesia give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

See the answer to question 7.3 above.

### 7.6 Independent Director. Will a court in Indonesia give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

See the answer to question 7.3 above.

## 8 Regulatory Issues

### 8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Indonesia, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Indonesia? Does the answer to the preceding question change if the purchaser does business with other sellers in Indonesia?

No licences are required to the extent that the purchaser is (i) solely purchasing and holding the receivables, and (ii) not established as a permanent legal entity in Indonesia.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

See the answer to question 8.1 above. A third party replacement servicer is not required to hold any licences in order to enforce and collect sold receivables to the extent it is solely purchasing and holding the receivables and does not intend to establish a permanent legal entity in Indonesia.

**8.3 Data Protection. Does Indonesia have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

Indonesia does not have specific regulations regarding data protection. However, Law No. 7 of 1992 on Banking as amended by Law No. 10 of 1998 provides that a bank has bank secrecy obligations which requires the banks to keep the confidentiality of any information regarding the depositor and his deposit. Meanwhile, information concerning debt is not deemed as confidential information and may be released.

Further, if the utilisation of information relating to personal data is made through electronic media, Law No. 11 of 2008 on Information and Electronic Transaction will apply where it requires such utilisation to be based on approval by the respective person.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Indonesia? Briefly, what is required?**

To the extent the agreement has been duly signed and has complied with the prevailing regulations and no continuing obligations need to be fulfilled, we believe that consumer protection law should not have any impact to the agreement.

**8.5 Currency Restrictions. Does Indonesia have laws restricting the exchange of Indonesia's currency for other currencies or the making of payments in Indonesia's currency to persons outside the country?**

There are no restrictions or requirements which limit the availability or transfer of foreign currency, except that pursuant to Regulation of Bank Indonesia number 10/28/PBI/2008 and Circular Letter of Bank Indonesia number 10/42/DPD, dated 27 November 2008, as amended by number 14/11/DPM/2012 dated 21 March 2012 and number 15/3/DPM/2013 dated 28 February 2013, the conversion of Indonesian Rupiah to foreign currencies or the purchase of foreign currency in the amount of more than US\$ 100,000 per month (or its equivalent) per customer (including the purchase of foreign currencies for derivative transactions) must be based on an underlying transaction, with a maximum amount required under the underlying transaction. In addition, the party purchasing the above-stated foreign currencies is required to submit the following documents to the bank making the conversion:

- (i) a copy of the underlying agreement;
- (ii) a Tax Registration Number for Indonesian parties (or known as NPWP); and
- (iii) a statement from the party purchasing the foreign currencies that the underlying agreement is a valid document and that

the foreign currency will only be used to settle the payment obligations under the underlying agreement.

## 9 Taxation

**9.1 Withholding Taxes. (a) Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Indonesia? (b) Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located. (c) In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? (d) In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

(a) If the obligors are Indonesian tax residents, the interest portion of the receivables would be subject to withholding tax.

(b) It does not depend on the nature of the receivables or the location of the seller or the purchaser.

(c) Yes.

(d) Yes.

**9.2 Seller Tax Accounting. Does Indonesia require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

Yes, it does.

**9.3 Stamp Duty, etc. Does Indonesia impose stamp duty or other documentary taxes on sales of receivables?**

Yes, it does.

**9.4 Value Added Taxes. Does Indonesia impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

Yes, it does.

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

No, it will not.

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Indonesia, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Indonesia?**

No, unless the withholding tax is imposed by the seller upon the sale.

## Acknowledgment

The authors would like to thank Anastasia Irawati (Tel: +62 21 250 5125/5136; Email: [airawati@abnrlaw.com](mailto:airawati@abnrlaw.com)) for her invaluable assistance in writing this chapter.



### Freddy Karyadi

Ali Budiardjo, Nugroho, Reksodiputro  
Graha CIMB Niaga 24th Fl.; Jl.  
Jend. Sudirman Kav. 58  
Jakarta 12190  
Indonesia

Tel: +62 21 250 5125/5136  
Fax: +62 21 250 5001/5121/5122/5392  
Email: [fkaryadi@abnrlaw.com](mailto:fkaryadi@abnrlaw.com)  
URL: [www.abnrlaw.com](http://www.abnrlaw.com)

Mr. Freddy Karyadi joined ABNR as senior associate in July 2007 and became a Partner on 1 January 2012. He read law at the University of Indonesia (1998) and Leiden University, majoring in International Tax Law (2002). He also graduated cum laude in 1997 from the Faculty of Economics of Trisakti University in Jakarta. He has participated in various trainings and seminars in Indonesia and abroad. Prior to joining ABNR, he worked for a number of years in other prominent law firms in Jakarta. In 2010, he was seconded to Loyens & Loeffs, Amsterdam Office, a prominent Dutch law firm. His special practice areas are capital market, M&A, taxation, banking and corporate finance matters. He has represented numerous financial institutions, banks, private equity and funds, and multinational companies.

He is a member of the editorial board of Derivatives and Financial Instrument Journal, International Bureau of Fiscal Documentation, the Netherlands and is the regional correspondent for the Indonesia jurisdiction for Tax Notes International of Virginia, United States. He also contributes articles to International Financial Law Review and a number of national tax magazines, teaches in several universities and is a regular speaker in seminars and trainings. In addition to being an advocate and tax attorney, he is also a registered accountant (Ak) and a licensed tax consultant (brevet C).



### Novario Asca Hutagalung

Ali Budiardjo, Nugroho, Reksodiputro  
Graha CIMB Niaga 24th Fl.; Jl.  
Jend. Sudirman Kav. 58  
Jakarta 12190  
Indonesia

Tel: +62 21 250 5125/5136  
Fax: +62 21 250 5001/5121/5122/5392  
Email: [nhutagalung@abnrlaw.com](mailto:nhutagalung@abnrlaw.com)  
URL: [www.abnrlaw.com](http://www.abnrlaw.com)

Mr. Novario Asca Hutagalung joined ABNR as an associate in May 2013. He graduated in 2010 from the Faculty of Law, Padjadjaran University, majoring in Economic Law. Prior to joining ABNR, he worked for a prominent law firm in Jakarta as an associate. In addition to that, he also has passed the Indonesian Bar exam as held by the Indonesian Advocates Association (Peradi).

In ABNR, he has been part of teams that assist clients in finance, mining, capital market, investment and other general corporate matters.



COUNSELLORS AT LAW

Ali Budiardjo, Nugroho, Reksodiputro, usually abbreviated to ABNR, was established in Jakarta in 1967 as a partnership of legal consultants in Indonesian business law. The firm is one of Indonesia's largest independent full-service law firms. The commitment we make to clients is to provide broad-based, personalised service from top quality teams of lawyers with international experience that includes groundbreaking deals and projects. ABNR's reputation has been recognised around the world by independent industry surveys and law firm guides. ABNR was selected, based on its high level of integrity and professionalism, to be the sole Indonesian member of the world's largest law firm association Lex Mundi and of the prestigious Pacific Rim Advisory Council (PRAC).

# Ireland

A&L Goodbody

Peter Walker



Jack Sheehy



## 1 Receivables Contracts

- 1.1 Formalities.** In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

To be enforceable against the obligor a debt obligation needs not be evidenced by a formal written contract, but must be evidenced as a matter of contract or deed. Contracts may be written, oral or partly written and partly oral. An invoice could itself constitute the contract between the seller and obligor if the standard elements of a contract are present. Where a contract is oral, evidence of the parties’ conduct may be used in determining the terms of the contract. A contract may also be implied based on a course of conduct or dealings between the parties.

- 1.2 Consumer Protections.** Do Irish laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

Consumer credit agreements are regulated by the Consumer Credit Act 1995 (as amended) (the CCA) and the European Communities (Consumer Credit Agreements) Regulations 2010 (as amended) (the CCA Regulations).

There is no statutory interest rate cap, but under the CCA if the cost of credit under a credit agreement is excessive it may be unenforceable.

There is no statutory right to interest on late payments, but contractual “default interest” may be imposed (as long as the rate of such default interest is not so high as to constitute a penalty).

If a consumer credit agreement does not comply with the requirements of the CCA, the creditor will not be able to enforce it. Certain clauses in a receivables contract with a consumer could be also found to be unfair under the European Communities (Unfair Terms in Consumer Contracts) Regulations 1995 (the UTCCR Regulations) and hence unenforceable.

The Consumer Protection Code (the CPC) of the Central Bank of Ireland (the CBI) also imposes obligations on “regulated entities” in their dealings with their “customers”. The Consumer Protection Act 2007 contains a general prohibition on unfair, misleading,

aggressive and prohibited trading practices that could result in a contract with a consumer being rendered void or unenforceable.

- 1.3 Government Receivables.** Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Under the Prompt Payments of Accounts Act 1997, all Irish public bodies and contractors on public sector contracts must pay amounts due to their suppliers promptly (i.e. on or before the due date in the contract or, if there is no due date (or no written contract), within 45 days of receipt of the invoice or delivery of the global servicers).

In certain circumstances, enforceability of receivables contracts with the government/a government agency could potentially be an issue as a result of the law of sovereign immunity.

## 2 Choice of Law - Receivables Contracts

- 2.1 No Law Specified.** If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Ireland that will determine the governing law of the contract?

Contracts entered into on or after 17 December 2009 will be governed by Regulation (EC) 593/2008 of 17 June 2008 (**Rome I**). Contracts entered into prior to 17 December 2009 will be subject to the Contractual Obligations (Applicable Law) Act 1991, pursuant to which the Rome convention on the law applicable to contractual obligations (the **Rome Convention**) was enacted in Ireland.

Under Rome I in the absence of an express choice of law in a contract, the applicable law of the contract will be that of the country with which it has the “closest connection”, which is the country where the party who is to perform the contract has his habitual residence or its central administration (unless the contract is within one of a number of defined classes for which specific rules apply or is manifestly more closely connected with the law of a different country, or if it is sufficiently certain from the terms or circumstances of the contract which law the parties intended to apply).

Under the Rome Convention the applicable law of a contract is presumed to be that of the country with which it has the “closest connection” (i.e. the country where the party performing the contract has his habitual residence or its central administration). However, if the contract is a commercial or professional contract,

the applicable law will be the law of the place in which the principal place of business of the party performing the contract is situated or, where performance is to be effected through a place of business other than the principal place of business of that party, the country in which that other place of business is situated.

If the contract falls outside the scope of Rome I or the Rome Convention, Irish common law principles will determine the applicable law by reference to the parties' intentions. If the parties' intention cannot be established, the applicable law will be the law with which the contract has its closest and most real connection.

**2.2 Base Case. If the seller and the obligor are both resident in Ireland, and the transactions giving rise to the receivables and the payment of the receivables take place in Ireland, and the seller and the obligor choose the law of Ireland to govern the receivables contract, is there any reason why a court in Ireland would not give effect to their choice of law?**

In those circumstances the Irish courts should give effect to the choice of Irish law.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Ireland but the obligor is not, or if the obligor is resident in Ireland but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Ireland give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

As discussed above, Rome I and the Rome Convention provide that the parties to a contract may freely choose the law of their contract and that choice is generally only overridden if it conflicts with mandatory rules or public policy. Contracts falling outside the scope of Rome I or the Rome Convention will be subject to standard Irish common law principles which also generally support the parties' choice of law and will only displace that choice in exceptional circumstances.

**2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Ireland?**

No, it is not.

### 3 Choice of Law - Receivables Purchase Agreement

**3.1 Base Case. Does Irish law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Irish laws or foreign laws)?**

Irish law does not require the sale of receivables to be governed by the law governing the receivables themselves. Whether under Rome I, the Rome Convention or principles of common law, subject to certain exceptions, the parties to a contract can choose the law of any country to govern the contract irrespective of the law governing the receivable.

However, whether a receivable has been validly sold and whether such sale has been perfected will generally be a matter for the law governing the receivable and not the law governing the receivables purchase agreement. Furthermore, the enforceability of the receivables against the obligor may be determined by the law of the jurisdiction in which the obligor is located.

**3.2 Example 1: If (a) the seller and the obligor are located in Ireland, (b) the receivable is governed by the law of Ireland, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Ireland to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Ireland, will a court in Ireland recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?**

Yes, it should.

**3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Ireland, will a court in Ireland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?**

See section 2 and question 3.1 above. In addition, under Rome I and the Rome Convention, laws other than the governing law of the receivables purchase agreement may sometimes be taken into account. For instance, where a contract is governed by Irish law but will be performed in a place other than Ireland, the Irish courts might apply certain mandatory provisions of the law of the country where the contract is to be performed (if the contract would be otherwise rendered unlawful in that country).

**3.4 Example 3: If (a) the seller is located in Ireland but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Ireland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Irish own sale requirements?**

As per section 2 and questions 3.1 and 3.3 above, under Rome I and the Rome Convention where there is an express choice of law by the parties to a contract, the Irish courts should recognise the choice of law and assess the validity of the contract in accordance with the law chosen by the parties.

However, certain mandatory principles of Irish law cannot be disapplied and the courts might not apply the parties' chosen law to the extent it conflicted with those mandatory principles.

**3.5 Example 4:** If (a) the obligor is located in Ireland but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Ireland recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Irish own sale requirements?

Yes. See section 2 and questions 3.1, 3.3 and 3.4 above.

**3.6 Example 5:** If (a) the seller is located in Ireland (irrespective of the obligor's location), (b) the receivable is governed by the law of Ireland, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Ireland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Ireland and any third party creditor or insolvency administrator of any such obligor)?

Yes. See section 2 and questions 3.1, 3.3, 3.4 and 3.5 above.

## 4 Asset Sales

**4.1 Sale Methods Generally.** In Ireland what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

In Ireland receivables are most commonly sold by way of legal (or equitable) assignment. Other methods which are more rarely used include: a declaration of trust over the receivables (or over the proceeds of the receivables), a sub-participation or a novation. An outright sale of receivables may be described as a "sale", a "transfer" or an "assignment", although "assignment" often indicates a transfer of the rights in respect of the receivables (and not the obligations), while a "transfer" often indicates a transfer of both rights and obligations by way of novation. The phrase "security assignment" is often used to distinguish a transfer by way of security from an outright assignment.

**4.2 Perfection Generally.** What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

A sale of receivables by way of an outright legal assignment is perfected by the delivery of notice in writing of the sale to the obligor(s) of the relevant receivables of the receivables in accordance with the requirements of Section 28(6) of the Supreme Court of Judicature (Ireland) Act 1877 (the **Judicature Act**). The provision of notice does not of itself result in the transfer becoming a legal (as opposed to an equitable) assignment as certain other formalities are also required, namely: (i) the assignment must be in writing under the hand of the assignor; (ii) it must be of the whole of the debt; and (iii) it must be absolute and not by way of charge. If the assignment does not fulfil all these requirements, it will likely take effect as an equitable

assignment so that any subsequent assignment effected by the seller which is fully compliant with the Judicature Act requirements will take priority if notified to the obligor prior to the date on which the original assignment is notified to the obligor.

A novation of receivables (i.e. of both the rights and obligations in respect of such receivables) requires the written consent of the obligor, the seller and the purchaser.

**4.3 Perfection for Promissory Notes, etc.** What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

The transfer requirements for promissory notes (as well as other negotiable instruments) are governed by the Bills of Exchange Act 1882, which provides that they are transferable by delivery (or delivery and endorsement).

Mortgage loans and their related mortgages may be transferred by way of assignment. For a mortgage over real property in order to effect a full legal (rather than just equitable) assignment, the transfer will need to be registered at the Land Registry or the Registry of Deeds (whether the land is registered or unregistered). Most residential mortgage-backed securitisation transactions are structured as an equitable assignment of mortgage loans and their related mortgages to avoid giving notice to the underlying mortgagors and registering the transfer. Under the CBI's Code of Conduct on the Transfer of Mortgages (if applicable), a loan secured by a mortgage of residential property may not be transferred without the written consent of the borrower (the relevant consent is usually obtained from the mortgage origination documentation).

Questions 8.3 and 8.4 below outline some of the regulatory requirements in relation to consumer loans. Under the CCA Regulations, a consumer must be provided with notice of any transfer by the creditor of its Loan, except where the original creditor continues to service the credit. Under the CPC where part of a regulated business is transferred by a regulated entity (including a transfer of consumer loans) at least two months' notice must be provided to affected consumers if the transferee is another regulated entity (and one month if it is not).

Marketable debt securities in bearer form, may be transferred by delivery and endorsement; in registered form, by registration of the transferee in the relevant register. Dematerialised marketable securities may be transferred by debiting the clearing system account of the purchaser (or its custodian or nominee/intermediary).

**4.4 Obligor Notification or Consent.** Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

A seller or purchaser need not notify the obligors to effect a valid equitable sale of the receivables (which would be effective against the seller). However, in order for a legal sale of the receivables to be effected (enforceable against both the seller and the underlying obligor) notice would need to be provided.

The obligors' consent is not required for the sale to be effective against them.

In the absence of an express contractual prohibition on assignment, receivables may be assigned without the obligor's consent. If there is a contractual prohibition on assignment, other methods of transfer may be available (see question 4.1 above) depending on the precise wording of the contract.

If notice is not provided: (i) obligors can discharge their debts by paying the seller; (ii) obligors may set-off claims against the seller even if they accrue after the assignment; (iii) a subsequent assignee without notice of the prior assignment would take priority over the claims of the initial purchaser; and (iv) the purchaser cannot sue the obligor in its own name, but must join the seller as co-plaintiff.

**4.5 Notice Mechanics.** If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

Notice must be in writing and given to the obligor at the time of, or after the sale (preferably after), but there is no particular form specified. The notice should clearly state that the obligor must pay the assignee (the purchaser) going forward.

There is no specific time limit for the giving of notices set down in the Judicature Act and notice can be given to obligors post-insolvency of the obligor or the seller (including pursuant to an irrevocable power of attorney granted by the seller). The notice should only apply to specific receivables.

**4.6 Restrictions on Assignment - General Interpretation.** Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?

Either of these formulations would likely be interpreted by an Irish court as prohibiting a transfer of relevant receivables by the seller to the purchaser (see our response to question 4.7 below).

**4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Ireland? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Ireland recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Restrictions on assignment or transfers are generally enforceable in Ireland. If a contract is silent on the question of assignment, then a

contract (and the receivables arising thereunder) will normally be freely assignable. If an assignment is effected in breach of a contractual prohibition on assignment it will be ineffective as between the obligor and the seller, but should still be effective as between the seller and purchaser.

**4.8 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The sale document must specify the receivables being sold with sufficient clarity that they are identifiable and distinguishable from the rest of the seller's assets. The receivables being sold need not share objective characteristics but normally a portfolio of receivables being sold is all of the same type. To our knowledge, the scenario has not been considered by the Irish courts but a purported sale of all of a seller's receivables other than those owing by specifically identified obligors might be effective if the contract sufficiently identifies the receivables not being sold.

**4.9 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

If a transaction is expressed to be a sale and the sale agreement (and other documents) purport to effect a sale but this does not reflect the actual agreement between the parties, the purported sale could be recharacterised as a secured loan. Irrespective of the label given to a transaction by the parties, the court will look at its substance (including the particular economic characteristics of the transaction) and will examine whether it creates rights and obligations consistent with a sale.

English case law (which is only of persuasive authority in the Irish courts and is not binding on them) has established a number of key questions which must be considered when determining whether a transaction is a sale rather than a secured loan:

- (i) Is the transaction a "sham"?, (i.e. do the transaction documents accurately reflect the intention of the parties or is there some other agreement or agreements that constitute the real transaction between the parties)?
- (ii) Does the seller have the right to reacquire the receivables?
- (iii) Does the purchaser have to account for any profit made by it on the sale of the receivables?
- (iv) Is the seller required to compensate the purchaser if it ultimately realises the acquired receivables for an amount less than the amount paid?

Although it will depend on the particular circumstances, the fact that the seller remains as servicer/collection agent of the receivables post-sale, or retains some degree of credit risk in respect of the



receivables post-sale, is not considered to be inconsistent with the transfer being treated as a sale (rather than a secured loan).

There is no Irish case law on the point, but a right of repurchase/redemption for the seller would likely be inconsistent with the transaction being one of true sale. However, if the seller has only a right to ask the purchaser to sell the receivables back, such an arrangement might not be inconsistent with a true sale.

If the sale is recharacterised as a secured loan, the assets “sold” will remain on the seller’s balance sheet and the loan will be shown as a liability of the seller. In addition, as it is not the practice in Ireland to make “back-up” security filings, the security may not have been registered and may be void in an insolvency of the seller for lack of registration.

In addition to recharacterisation, sale transactions are also vulnerable under certain provisions of the Irish Companies Acts 1963 to 2013 (the Companies Acts) such as Section 139 of the Companies Act 1990 (improper transfers of company assets) and Section 286 of the Companies Act 1963 (fraudulent preferences).

---

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

---

Yes. However, the sale of the receivables would need to be by way of an equitable assignment (an agreement whereby a seller purports to sell receivables on a continuous basis will generally take effect as an agreement to assign); the receivables will then be automatically equitably assigned as and when they come into existence.

---

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?**

---

Yes. See question 4.10 above – an assignment of a receivable not in existence at the time of the agreement, but which will be ascertainable in the future, is treated as an agreement to assign and should give rise to an equitable assignment as soon as the receivable comes into existence. See question 6.5 for the effect the seller’s insolvency could have on such an agreement to assign.

---

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

---

Related security will typically be capable of being assigned in the same manner as the receivables themselves. The transfer or assignment of certain types of security may require additional formalities (some of which are referred to in question 4.3 above).

---

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

---

Until notice of the sale of the receivables contract is provided to the relevant underlying obligor, the obligor will be entitled to exercise any rights of set-off against the purchaser even if they accrue after the date of the sale. It would likely depend on the circumstances, but if an obligor’s set-off rights were terminated due to notice or for some other valid reason, the seller or purchaser should not be liable to the obligor for damages caused as a result.

---

## 5 Security Issues

---



---

**5.1 Back-up Security. Is it customary in Ireland to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

---

It is not customary in Ireland to take such a “back-up” security when the intention is to effect an outright sale of the relevant receivable.

---

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Ireland, and for such security interest to be perfected?**

---

See question 5.3 (below).

---

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Ireland to grant and perfect a security interest in purchased receivables governed by the laws of Ireland and the related security?**

---

Security is most commonly taken over receivables by way of a legal (or equitable) assignment or a charge over book debts.

Receivables assigned by way of security will create a mortgage over the receivables, either legal (if the requirements of the Judicature Act are followed – see question 4.2 above) or (in the absence of these requirements) equitable. Prior to the perfection of an equitable mortgage by notice to the obligor, the assignee’s security will be subject to prior equities (such as rights of set-off and other defences), and will rank behind a later assignment (where the later assignee has no notice of the earlier assignment and has itself given notice to the obligor). In addition, the obligor will be able to discharge its debt by continuing to pay the assignor (as described in questions 4.4 and 4.5).

Alternatively, a fixed or floating charge could be granted over the receivables. In comparison to a mortgage (which is a transfer of title together with a condition for re-assignment on redemption), a charge is a mere encumbrance on the receivables, giving the chargee a preferential right to payment out of the receivables in priority to other creditors of the relevant company.

A fixed charge is typically granted over specific receivables and attaches to those receivables upon the creation of the fixed charge. In comparison, a floating charge is normally granted over a class of assets (both present and future) which, prior to the occurrence of a “crystallisation event”, can continue to be managed in the ordinary course of the chargor’s business. On the occurrence of a crystallisation event, the floating charge will attach to the particular class of the chargor’s assets, effectively becoming a fixed charge over those assets. The chargee’s degree of control over the receivable is the determining factor in distinguishing a fixed from floating charge (and in that regard the Irish courts look at the substance of the security created, rather than how it is described or named).

In terms of perfection, if an Irish company grants security over certain types of assets (including receivables constituting book debts) (i.e. it creates a “registrable charge” for the purposes of the Companies Acts), it must register short particulars of the security created with the Irish Registrar of Companies within 21 days of its creation.

The European Communities (Financial Collateral Arrangements) Regulation 2004 (as amended) and the European Communities (Financial Collateral Arrangements) Regulations 2010 (as amended) (together, the **Financial Collateral Regulations**) provide that security over “financial collateral” (cash, financial instruments and credit claims) that constitutes a “security financial collateral arrangement”, although it constitutes a registrable security interest under the Companies Acts, does not need to be registered with the Registrar of Companies. However, it is still customary to register these charges.

Failure to register a registrable security interest within 21 days of its creation will result in that security interest being void as against the liquidator and any creditors of the company which created the registrable charge. However, an unregistered charge will still be valid as against the chargor, provided the chargor is not in liquidation.

Registration of a charge under the Companies Act does not determine priority so that, provided both charges are registered within the 21-day period after creation, a prior created charge will take priority over a subsequently created charge even where that later charge is registered first.

---

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Ireland, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Ireland or must additional steps be taken in Ireland?**

---

The relevant security must be valid and perfected under the laws of Ireland and under the governing law of the security, in order for it to be given effect by the Irish courts. Accordingly, if the security over the receivables is created by a purchaser which is an Irish company or by a foreign company and the receivables are situated in Ireland, details of the security will generally need to be filed with the Registrar of Companies within 21 days of its creation (see question 5.3 above).

---

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

---

A security assignment is usually taken over insurance policies.

Security over mortgage or consumer loans will be created by mortgage or charge. An equitable mortgage is typically created over the mortgage securing a mortgage loan.

The type of security over marketable debt securities depends on whether the relevant securities are bearer or registered, certificated, immobilised or dematerialised and/or directly-held or indirectly held: (i) directly-held and certificated debt securities, where registered, are generally secured by legal mortgage (by entry of the mortgagee on the relevant register) or by equitable mortgage or charge (by security transfer or by agreement for transfer or charge); (ii) security over bearer securities may be created by mortgage or pledge (by delivery together with a memorandum of deposit) or charge (by agreement to charge); and (iii) security may be created over indirectly-held certificated debt securities by legal mortgage (by transfer, either to an account of the mortgagee at the same intermediary or by transfer to the mortgagee’s intermediary or nominee via a common intermediary) or by equitable mortgage or charge (by agreement of the intermediary to operate a relevant securities account in the name of the mortgagor containing the debt securities to the order/control of the chargee).

The security interests described above may be registrable with the Registrar of Companies under the Companies Acts. If the security interest contributes a “security financial collateral arrangement”, the Financial Collateral Regulations may apply (see question 5.3 above).

---

**5.6 Trusts. Does Ireland recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?**

---

Ireland recognises trusts, and a trust over collections received by the seller in respect of sold receivables should be recognised under the laws of Ireland (provided it is validly constituted).

---

**5.7 Bank Accounts. Does Ireland recognise escrow accounts? Can security be taken over a bank account located in Ireland? If so, what is the typical method? Would courts in Ireland recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Ireland?**

---

Ireland recognises the concept of money held in escrow in a bank account. Security may be taken over a bank account in Ireland and is typically taken by way of a charge or security assignment. Security over a credit balance granted by a depositor in favour of the bank at which such deposit is held can only be achieved by way of charge (not by assignment). If the security constitutes a “security financial collateral arrangement” over “financial collateral” within the meaning of the Financial Collateral Regulations, then those regulations should apply (as to which, see question 5.3 above).

Foreign-law governed security over an Irish situated bank account must be valid under both Irish law and the foreign law in order for it to be given effect by the Irish courts (see question 5.4 above).

---

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

---

Normally, notice of the creation of security over the account is provided to the bank with which the account is held, and an

acknowledgment sought that the bank will, *inter alia*, (upon notification that the security has become enforceable) act in accordance with the instructions of the secured party. So if such an acknowledgment has been obtained, once the secured party enforces its security over the relevant bank account, the bank should follow its instructions in respect of all cash in (or flowing into) the account until the obligations owed to the secured party are discharged in full.

However, this control is conferred on the secured party by contract – the bank could refuse to act in accordance with the secured party’s instructions. Furthermore, rights of set-off (under statute, common law or contract) might be exercisable in respect of the cash in the account to the detriment of the secured party. Finally, under Irish banking crisis resolution legislation, the CBI and the Minister for Finance have powers to direct the activities of Irish credit institutions in certain circumstances, and the exercise of such powers could interfere with the secured party’s control over the bank account.

---

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

---

This depends on the type of security granted over the account/account balance. If a floating charge is granted, the fact that the owner of the account may access funds in the account should not affect the validity of the floating charge. However, if the security granted purports to be a fixed charge, the more freely the owner can access the funds in the account, the less likely the charge would actually be treated as a fixed charge and the more likely it would be recharacterised as being a floating charge.

---

## 6 Insolvency Laws

---

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Irish insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

---

The appointment of a liquidator or an examiner to an insolvent Irish company imposes an automatic stay of action against the entity, but if the receivables have been transferred by legal assignment, the sale will have already been perfected, and the stay should not affect the purchaser’s ability to enforce its rights in the receivables.

If the seller has been appointed as the servicer of the receivables, the stay of action could block the purchaser from enforcing the servicing contract, and any amounts held by the servicer in respect of the receivables (other than if not held on trust for the purchaser under a valid and binding trust arrangement) could be deemed to form part of the insolvency estate of the servicer, and rather than being the property of the purchaser.

If only an equitable assignment has been effected (i.e. no notice has been given to an obligor), an obligor may continue to pay the seller. Normally, the seller will hold any such amounts on trust for the purchaser, but if no such trust has been created, such amounts will

likely form part of the seller’s insolvency estate and the purchaser would be an unsecured creditor of the seller in respect of those amounts.

---

**6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?**

---

See question 6.1 above. Assuming the receivables have been sold by legal assignment or by means of a subsequently perfected equitable assignment, an Irish insolvency official appointed over the seller should not be able to prohibit the purchaser’s exercise of its rights (unless there has been a fraudulent preference or an improper transfer of company assets, as described below).

---

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Ireland for (a) transactions between unrelated parties, and (b) transactions between related parties?**

---

Under Section 139 of the Companies Act 1990, if a liquidator can show that any company property was disposed of and the effect was to “perpetrate a fraud” on either the company, its creditors or its members, the High Court may, if just and equitable, order any person who appears to have “use, control or possession” of the property or the proceeds of the sale or development thereof, to deliver it or pay a sum in respect of it to the liquidator on such terms as the High Court sees fit.

Section 286 of the Companies Act 1963 (as amended) provides that any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company, which is unable to pay its debts as they become due to any creditor, within six months of the commencement of a winding up of the company with a view to giving such creditor (or any surety or guarantor of the debt due to such creditor) a preference over its other creditors, will be invalid. Case law indicates that a “dominant intent” must be shown on the part of the entity concerned to prefer a creditor over other creditors. Furthermore, Section 286 is only applicable if at the time of the conveyance, mortgage or other relevant act, the company was already insolvent. Where the conveyance, mortgage, etc. is in favour of a “connected person”, the six-month period is extended to two years.

Section 288 of the Companies Act 1963 (as amended) renders invalid (except to the extent of monies actually advanced or paid or the actual price or value of the goods or services sold or supplied to the company at the time of, or subsequently to, the creation of the charge, together with interest on that amount at the rate of 5 per cent *per annum*) floating charges on the property of a company created within 12 months before the commencement of the winding up of that company (unless the company was solvent immediately after the creation of the charge). Where the floating charge is created in favour of a “connected person”, the 12-month period is extended to two years.

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

Irish law gives an Irish court the power, in certain circumstances, to treat the assets and liabilities of one company as though they were assets and liabilities of any other.

An Irish court may exercise its equitable jurisdiction and treat two or more companies as a single entity if this conforms to the economic and commercial realities of the situation and the justice of the case so requires.

Furthermore, if an Irish company goes into liquidation or examination, the Companies Acts specify particular scenarios where an Irish court has the power to “make such order as it thinks fit” in respect of transactions entered into by that company to restore the position to what it would have been if it had not entered into the transaction. In addition, in certain limited instances, a court may “pierce the corporate veil”.

Also, depending on the particular case, a court may: (i) order that the appointment of an examiner to a company be extended to a “related company” of the company in examination; (ii) (if it is just and equitable to do so) order that any related company of a company being liquidated pay some or all of the debts of the company in liquidation (a “contribution order”); or (iii) provide that where two or more “related companies” are being wound up (and it is just and equitable to do so), both companies be wound up together as if they were one company (a “pooling order”).

However, case law suggests that the above powers/orders will only be exercised/granted in exceptional circumstances.

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Ireland, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

If a true sale of the receivables (including future receivables) has already been effected, the purchase price for the receivables has been paid (subject to the matters described in questions 6.1 and 6.3 above), and no further action is required by the seller, the seller’s insolvency should not of itself affect the purchaser’s rights as purchaser of the receivable.

If a receivables purchase agreement has been entered into, but the purchase price is not paid prior to the seller’s insolvency, the purchaser will be left as an unsecured creditor of the seller.

**6.6 Effect of Limited Recourse Provisions. If a debtor’s contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

A contractual provision limiting the recourse of the creditors of the debtor (as specified in question 7.3 below) is likely to be valid as a matter of Irish law (although such provisions have not yet been adjudicated upon by the Irish courts). Accordingly, if all of the debtor’s contracts contain a limited recourse provision whereby its creditors agree to limit their recourse to the debtor (and assuming the limited recourse provision operates correctly), it should not be

possible for the debtor to be declared insolvent on grounds that it cannot pay its debts as they become due.

## 7 Special Rules

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Ireland establishing a legal framework for securitisation transactions? If so, what are the basics?**

Yes. Section 110 of the Taxes Consolidation Act 1997 (the TCA) allows for the special treatment of Irish companies (Section 110 SPVs) under which securitisations and other structured transactions can be effected. Section 110 SPVs are normal Irish private limited companies incorporated under the Companies Acts which, if they meet the conditions set out in Section 110, have their profits calculated for Irish tax purposes as if they were carrying on a trade.

This enables them to take deductions for all expenditure, in particular, interest payments that must be made on the debt instruments issued by them. This ensures that there is very little or no Irish tax payable by Section 110 SPVs. This legislative regime has facilitated the development of securitisation in Ireland, and Section 110 SPVs have been used in numerous cross-border securitisations.

There are also generous exemptions available from Irish withholding tax on payments of interest made by Section 110 SPVs which are structured to fall within the securitisation legislation (these are discussed in more detail in question 9.1). One clear advantage for Section 110 SPVs is that they can make payments of “profit dependent” interest without any negative implications and can use straight “pass through” structures, for example, collateralised debt obligations.

In order to avail of the relief under Section 110, the company must be a “qualifying company” i.e. it must:

- be resident in Ireland;
- acquire “qualifying assets”;
- carry on in Ireland a business of holding, managing, or both the holding and management of, qualifying assets;
- apart from activities ancillary to that business, carry on no other activities;
- the market value of the qualifying assets is not less than €10 million on the day on which they are first acquired; and
- have notified the Revenue Commissioners that it is or intends to be a Section 110 company.

A company shall not be a qualifying company if any transaction or arrangement is entered into by it otherwise than by way of a bargain made at arm’s length.

The definition of “qualifying assets” is non-exhaustive and includes shares, bonds, receivables, other securities, futures, etc.

**7.2 Securitisation Entities. Does Ireland have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

Irish law does not specifically provide for the establishment of special purpose entities for securitisation transactions, but see question 7.1 above.

- 7.3 Limited-Recourse Clause.** Will a court in Ireland give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

A contractual provision limiting the recourse of the creditors of an entity to its available funds is likely to be valid under Irish law (whether the contract's governing law is Irish or the law of another country).

- 7.4 Non-Petition Clause.** Will a court in Ireland give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Although there is little authority in Irish law, it is likely that an Irish court would give effect to contractual provisions (whether governed by Irish law or the law of another country) prohibiting the parties to the relevant contract from taking legal action (or commencing an insolvency proceeding) against the purchaser or another person.

It is possible that an Irish court would consider an insolvency winding-up petition even if it were presented in breach of a non-petition clause. A party may have statutory or constitutional rights to take legal action against the purchaser/another person, which may not be contractually disapplied and a court could hold that the non-petition clause was contrary to Irish public policy on the grounds referred to above (i.e. ousting of court jurisdiction and/or Irish insolvency laws).

- 7.5 Priority of Payments "Waterfall".** Will a court in Ireland give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

An Irish court should generally give effect to a contractual provision (whether the contract's governing law is Irish or the law of another country) distributing payments to an Irish company's creditors in a certain order. However, in an insolvency of an Irish company certain creditors are given preferential status by statute and so the contractual priority of payments provision could be altered.

- 7.6 Independent Director.** Will a court in Ireland give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

An Irish court should give effect to such a provision or article in an Irish company's articles of association.

However, any provision which purports to restrict or limit the directors' ability to bring insolvency proceedings may be invalid on public policy grounds or as incompatible with the directors' statutory duties.

## 8 Regulatory Issues

- 8.1 Required Authorisations, etc.** Assuming that the purchaser does no other business in Ireland, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Ireland? Does the answer to the preceding question change if the purchaser does business with other sellers in Ireland?

If the underlying obligors are consumers, the CCA (and the other consumer protection legislation and codes discussed in question 1.2 above and question 8.4 below) may be applicable (irrespective of whether the purchaser is dealing with one or more sellers in Ireland). The CCA provides for the licensing of three categories of activity, acting as: (i) a moneylender; (ii) a credit intermediary; or (iii) a mortgage intermediary. If the underlying obligors are natural persons and there is any form of credit being provided, consideration should be had to the retail credit firm authorisation requirements of the CBI under the Central Bank Act 1942 to 2013. In addition, under Irish data protection legislation, the purchaser might need to register with the Irish Data Protection Commissioner as a "data controller" or a "data processor".

- 8.2 Servicing.** Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

The seller does not need a licence in order to continue to enforce and collect receivables following their sale to the purchaser, as debt collection is not a specifically licensed activity in Ireland. However, with respect to any consumer receivables it continues to service, it would need to comply with applicable Irish consumer protection legislation (e.g. the CPC). The seller would also need to be registered with the Data Protection Commissioner. Where the seller continues to act as servicer with respect to residential mortgage loans, it will need to be authorised to perform such role by the CBI. Any standby or replacement servicer would require the same licences and authorisations.

- 8.3 Data Protection.** Does Ireland have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

The Irish Data Protection Act, 1988 and the Irish Data Protection (Amendment) Act 2003 (the DPAs) restrict the use and dissemination of personal data in relation to "data subjects", which are "individuals" (i.e. natural persons and not corporate entities).

The DPAs regulate the collection, processing, use and disclosure of data and provide, *inter alia*, that such data must be kept for one or more specified and lawful purposes only, that it must be used and disclosed only in ways compatible with those purposes, and be kept safe and secure.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Ireland? Briefly, what is required?**

If the obligors are “consumers” then a bank acting as purchaser will need to comply with the terms of its authorisation and the applicable codes of conduct/advertising rules (e.g. the CPC) or other Irish consumer protection laws, including the CCA, the CCA Regulations and the UTCCR Regulations.

The CCA imposes a number of obligations on credit intermediaries and also provides protections to consumers (e.g. by regulating the advertising of consumer credit, and by bestowing a “cooling-off” period in favour of the consumer after signing an agreement).

The CCA Regulations apply to loans to consumers where the amount lent is between €200 and €75,000. The main provisions of the CCA relate to, *inter alia*: (i) standardisation of the information to be contained in a credit agreement; (ii) standardisation of pre-contractual information; and (iii) a full 14-day “right of withdrawal” for consumers from the relevant credit agreement.

Where there is a significant imbalance in the parties’ rights and obligations under a consumer contract to the detriment of the consumer, the UTCCR Regulations may apply. The UTCCR Regulations contain a non-exhaustive list of terms which will be deemed “unfair” and the list includes terms which attempt to exclude or limit the legal liability of a seller in the event of the death of, or personal injury to, a consumer due to an act or omission by the seller, or require any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation. If a term is unfair it will not be binding on the consumer. However, the contract should continue to bind the parties, if it is capable of continuing in existence without the unfair term.

The CPC imposes general obligations on “regulated entities” dealing with “customers” in Ireland (primarily “consumers”), to act honestly, fairly and professionally and with due skill, care and diligence in the best interests of their customers and to avoid conflicts of interest.

If there is no obligation on a non-bank purchaser to provide any funding to a consumer, then it should not need to be licensed, but might still need to comply with the CCA, the UTCCR Regulations, the CPC and the CCA Regulations (if applicable).

**8.5 Currency Restrictions. Does Ireland have laws restricting the exchange of Irish currency for other currencies or the making of payments in Irish currency to persons outside the country?**

Ireland does not have any exchange control laws. Certain financial transfer orders in place from time to time may restrict payments to certain countries, groups and individuals subject to UN sanctions.

## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Ireland? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

It is usually possible to structure a securitisation (especially when using a Section 110 SPVs) so that payments on receivables are not subject to Irish withholding tax.

There is a general obligation to withhold tax from any payment of yearly interest made by an Irish company. The rate of withholding is currently 20 per cent. Therefore, in principle, if the debtor is an Irish person and the receivable has a maturity of more than one year it is likely this withholding obligation will arise. Interest paid by Irish debtors to a Section 110 SPVs should come within an exemption from interest withholding tax.

Exemptions also exist for interest payments made by a Section 110 SPVs. There is an exemption for interest paid by a Section 110 SPVs to a person who is resident for the purpose of tax in an EU Member State (other than Ireland) or in a country with which Ireland has a double tax treaty (except in a case where the person is a company where such interest is paid to the company in connection with a trade or a business which is carried on in Ireland by the company through a branch or agency).

There is also an exemption for interest paid on a quoted eurobond, where either:

- (a) the person by or through whom the payment is made is not in Ireland i.e. non Irish paying agent; or
- (b) the payment is made by or through a person in Ireland, and either:
  - (i) the quoted eurobond is held in a recognised clearing system (Euroclear and Clearstream SA are so recognised); or
  - (ii) the person who is a beneficial owner of the quoted eurobond and who is beneficially entitled to the interest is not resident in Ireland and has made a declaration to this effect.

A quoted eurobond means a security which is:

- (a) issued by a company;
- (b) quoted on a recognised stock exchange; and
- (c) carries a right to interest.

In the case of a sale of trade receivables, deferred purchase price should not be recharacterised in whole, or in part, as interest. It should be considered to be a payment made for the acquisition of the receivables, and not a payment of interest.

**9.2 Seller Tax Accounting. Does Ireland require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

A company qualifying for the favourable Irish tax treatment provided for by Section 110 of the TCA will be, subject to certain adjustments required by law, subject to Irish corporation tax on its

profit according to its profit and loss account prepared in accordance with generally accepted commercial accounting principles in Ireland as at 31 December 2004 (i.e. before the introduction of IFRS), unless it elects otherwise.

---

### 9.3 Stamp Duty, etc. Does Ireland impose stamp duty or other documentary taxes on sales of receivables?

---

An agreement for the sale of, or an instrument effecting the sale of, debt having an Irish legal *situs* may be chargeable to Irish stamp duty absent an exemption. An instrument effecting the transfer of debt having a non-Irish *situs* may also be chargeable to Irish stamp duty, absent an exemption, if it is executed in Ireland or if it relates to something done or to be done in Ireland. There are certain exemptions from Irish stamp duty that may be relevant, such as the debt factoring exemption or loan capital exemption. A transfer by way of novation should not give rise to stamp duty.

---

### 9.4 Value Added Taxes. Does Ireland impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

---

Ireland does apply VAT on the sale of goods and services. The standard rate of VAT is 23 per cent.

A purchaser will be required to register and account, on a reverse charge basis, for Irish VAT at the rate of 23 per cent on the receipt by it of certain services from persons established outside Ireland. These services would include legal, accounting, consultancy and rating agency services and also financial services to the extent that those financial services are not exempt from Irish VAT.

The sale of receivables should be exempt from VAT. The services of a collection agent would normally be treated as exempt.

Where a purchaser would not be engaged in making VAT taxable supplies in the course of its business, it would not be able to recover VAT (1) payable by it in respect of the receipt of services outlined in the paragraph above, or (2) charged to it by suppliers of VAT-taxable services (e.g. the provision of legal, accounting and audit services by Irish providers, the provision of trustee and administration services and collection agent services).

---

### 9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

---

It depends on the nature of the VAT charge that arose. If the supply is received from an Irish supplier that should have levied VAT, then unless there is a contractual provision enabling the seller to claim the VAT off the purchaser, the person the Revenue Commissioners would make a claim against would be the seller. However, in the case of reverse charge services received from abroad, the accountable person would be the purchaser and the Revenue Commissioners could claim against the purchaser. In an arm's length transaction stamp duty should be for the account of the purchaser only.

---

### 9.6 Doing Business. Assuming that the purchaser conducts no other business in Ireland, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Ireland?

---

Liability to Irish corporation tax may arise if the purchaser is "carrying on a trade" in Ireland. The term "trade" is a case law-derived concept and there is no useful statutory definition of the term. However, in general, the purchase, collection and enforcement of the receivable should not be considered as "trading" under Irish law and the purchaser should not incur any Irish tax liabilities.

**Peter Walker**

A&L Goodbody  
25-28 North Wall Quay  
Dublin 1  
Ireland

*Tel:* +353 1 649 2202  
*Fax:* +353 1 649 2649  
*Email:* [pwalker@algoodbody.com](mailto:pwalker@algoodbody.com)  
*URL:* [www.algoodbody.com](http://www.algoodbody.com)

Peter Walker is a partner in the banking financial services department of A&L Goodbody and resident partner in our London office. His principal practice areas are asset backed finance (including portfolio sales and acquisitions), debt capital markets, private equity finance, general banking and restructurings. Recent transactions which Peter has been involved with include auto loan securitisations, a third party funded Irish auto loan securitisation, numerous performing and non-performing loan portfolio acquisitions and disposals (both secured and unsecured), trade receivable securitisations (multi-jurisdictional and purely domestic), high yield bond issues, CLO, RMBS and CMBS restructurings and the establishment of acquisition platforms and loan origination platforms for various private equity groups and hedge funds.

**Jack Sheehy**

A&L Goodbody  
Augustine House, 6A Austin Friars  
London EC2N 2HA  
United Kingdom

*Tel:* +44 207 382 0800  
*Fax:* +44 207 382 0870  
*Email:* [jsheehy@algoodbody.com](mailto:jsheehy@algoodbody.com)  
*URL:* [www.algoodbody.com](http://www.algoodbody.com)

Jack Sheehy is an associate in the banking financial services department of A&L Goodbody. His principal practice areas are debt capital markets, private equity finance and general banking and restructurings. Recent transactions include a number of performing and non-performing loan portfolio acquisitions and disposals, high yield bond issues, securitisation restructurings and the establishment of asset acquisition and loan origination platforms.

A&amp;L Goodbody



A&L Goodbody is internationally recognised as a leading Irish corporate law firm. Headquartered in Dublin, with offices in Belfast, London, New York, San Francisco and Palo Alto, the firm has a total staff of over 600. A&L Goodbody acts for domestic and global corporations, financial institutions, intermediaries and government. The firm advises on every area of business law including corporate and commercial, M&A, banking and financial services, taxation, property, as well as litigation and private client work.

The A&L Goodbody Securitisation and Capital Markets Group is one of the largest practices of its kind in Ireland. The Group acts for Irish and overseas originators, issuers, underwriters and arrangers in the full range of transactions. The team has extensive experience advising on domestic and international securitisations (including CLOs and CDOs), debt repackaging, bond issues, EMTN programmes, FRN issues, commercial paper programmes, certificates of deposit programmes and other debt capital market issuances.



# Italy

Chiomenti Studio Legale

Francesco Ago & Gregorio Consoli

## 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

(a) The general principle applicable under Italian law is that no formality exists in respect of the execution or evidence of contracts. Nonetheless, according to specific provisions of the law, written form is required for the validity of certain contracts or for providing evidence in respect thereof.

(b) Invoices may be construed as relevant receivables documents and they may be deemed to constitute evidence of a contractual relationship. Whenever the invoices represent a claim which is certain, liquid and payable (according to Article 633 of the Italian Civil Procedure Code), the relevant creditor may obtain from the court an injunction to pay against the debtor.

(c) The behaviour of the parties is not *per se* sufficient to be the base for the existence of a contract. Pursuant to Article 1362 of the Italian Civil Code, the behaviour of the parties may be used as an interpretation criterion, in order to establish the mutual intention of the parties.

**1.2 Consumer Protections. Do Italy’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

(a) Law No. 108 of 7 March 1996 (“**Usury Law**”) contains provisions limiting rates of interest applicable to receivables. In particular, the rate of interest exceeding the percentage rates published on a quarterly basis by the Ministry of Economy is considered to be void.

(b) Pursuant to Article 1224 of the Italian Civil Code, a debtor who fails to pay a monetary obligation will be bound to pay legal interest starting from the day of default even if the relevant agreement did not provide for the payment of any such interest. If the agreement provides for an interest rate higher than the legal interest rate, the default interest will be due at such rate.

(c) It is conceivable that, in specific circumstances and subject to specific provisions of the law, debtors may obtain a suspension of their payment obligations for a given period of time.

(d) The Italian legal system provides several instruments to protect consumers when they enter into an agreement with professional operators. Among others, please refer to Legislative Decree No. 206 of 6 September 2006 (the “**Consumers’ Code**”). In case of transfer of consumer loans, the consumer is entitled to raise against the purchaser the same exceptions it could have raised against the seller, including by way of derogation of Article 1248 of the Italian Civil Code, any right of set-off.

Articles 121 to 126 of Legislative Decree of No. 385 of 1 September 1993 (the “**Banking Law**”), as recently modified in order to comply with Directive 2008/48/CE, provide for the protection of consumers in the context of consumer credit transactions. In this regard, Legislative Decree No. 141 of 13 August 2010 introduced new forms of protection on the basis of certain transparency and disclosure duties applicable to lenders.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

The assignment of receivables owed by public entities is regulated by specific provisions of law (please refer, *inter alia*, to Royal Decree No. 2440 of 24 November 1923). Assignment of receivables is effective *vis-à-vis* public entities only if (a) the relevant assignment agreement is entered into in the form of a public deed or a notarised private deed, (b) the receivables assigned in the context of the agreement are all *vis-à-vis* a single debtor, and (c) the assignment is accepted by the debtor with date certain at law or notice thereof is given to the public entity through notification made by a court bailiff.

In case of receivables arising from a supply contract or bid contract (which have not been completely performed), the sale of the receivables is not valid without the public entity’s consent.

Moreover, according to the provisions of Article 117 of Legislative Decree No. 163 of 12 April 2006 (“**Public Contracts Law**”), a contractor may assign receivables arising from a public contract to banks or other financial intermediaries. Such agreement must be executed in the form of public deed or notarised private deed, notified to the relevant debtor and will be deemed to be perfected upon the expiration of a 45-day term starting from the date of

notification during which period the public debtor has the right to object to the assignment.

In the event that the assignment of receivables *vis-à-vis* public entities is realised in the context of a securitisation transaction, new Article 4-*bis* of Law No. 130 of 1999 (the “**Securitisation Law**”), as introduced by Law Decree No. 145 of 2013, as converted into Law No. 9 of 21 February 2014 (the “**Destinazione Italia Decree**”), shall apply. In accordance with such provisions, Royal Decree No. 2440 of 18 November 1923, requiring, *inter alia*, the sale to be perfected through a public or notarised deed, does not apply to the assignment of receivables towards public administration realised in the context of securitisation transactions; no other provisions requiring formalities different from, or additional to, those provided for under the Securitisation Law shall apply in this case.

Article 4-*bis* of the Securitisation Law also provides that the assignment or transfer of the servicer’s function to parties other than the originator shall be notified to public debtors by publication of a notice in the Official Gazette of the Republic of Italy and by a registered letter with acknowledgment of receipt.

## 2 Choice of Law - Receivables Contracts

### 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Italy that will determine the governing law of the contract?

Pursuant to Article 4, paragraph 1 of Regulation No. 593 of 2008 of the European Parliament and of the Council on the Law Applicable to Contractual Obligations (“**Rome I Regulation**”), if the parties have not made an explicit choice of the applicable law, different criteria will apply depending on the nature of relevant agreement. If the agreement does not fall within one of the categories set forth in paragraph 1 of the Rome I Regulation, it will be governed by the law of the country where the party required to effect the characteristic performance of the contract has his/her habitual residence. However, whenever it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than that identified by the abovementioned criterion, the law of that other country shall apply.

According to Article 6 of the Rome I Regulation, if the contract is entered into by a consumer, it shall be governed by the law of the country where the consumer has his habitual residence, provided that the professional: (a) pursues his commercial or professional activities in the country where the consumer has his/her habitual residence; or (b) by any means, directs such activities to that country or to several countries (including that country), and the contract falls within the scope of such activities.

### 2.2 Base Case. If the seller and the obligor are both resident in Italy, and the transactions giving rise to the receivables and the payment of the receivables take place in Italy, and the seller and the obligor choose the law of Italy to govern the receivables contract, is there any reason why a court in Italy would not give effect to their choice of law?

An Italian court would give effect to the choice of law made by the contracting parties. In the circumstances described above there would be no reason why Italian courts would not give effect to the choice of Italian law to govern the receivables.

### 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Italy but the obligor is not, or if the obligor is resident in Italy but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Italy give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

The parties to a contract may freely choose the law applicable to the whole or a part of the contract, and select the court that will have jurisdiction over disputes, provided that any such choice does not conflict with any provisions of Italian law of mandatory application. Generally, the principles setting limits to the recognition of foreign laws (such as public policy or mandatory principles of law) do not apply to commercial relationships. There might, nonetheless, be situations such as consumer contracts where Italian mandatory rules of law would apply notwithstanding any different choice of law by the parties.

### 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Italy?

Yes, it is.

## 3 Choice of Law - Receivables Purchase Agreement

### 3.1 Base Case. Does Italy’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Italy’s laws or foreign laws)?

According to the provision set forth under Article 14 of the Rome I Regulation, it is permitted that the sale of receivables be governed by a law other than the law governing the receivables themselves. In this case, the law governing the assigned claim shall determine whether the receivables are capable of being assigned, the relationship between the assignee and the debtor, the conditions under which the assignment can be opposed against the debtor and whether the debtor’s obligations have been discharged. Moreover, pursuant to Article 9 of the Rome I Regulation, overriding mandatory provisions must be applied whatever the law applicable to the contract might be.

### 3.2 Example 1: If (a) the seller and the obligor are located in Italy, (b) the receivable is governed by the law of Italy, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Italy to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Italy, will a court in Italy recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Pursuant to Article 11, paragraph 2, of the Rome I Regulation, a contract between persons who are in different countries at the time of its conclusion is formally valid if it satisfies the formal requirements provided by the law which governs the substance of the same. In the case envisaged, Italian courts would recognise the effectiveness of the sale.

- 3.3 Example 2:** Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Italy, will a court in Italy recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

As explained above with respect to question 3.1, according to Article 14, paragraph 2, of the Rome I Regulation, the law governing the assigned claims shall determine whether the receivables are capable of being assigned, the relationship between the assignee and the debtor, the conditions under which the assignment can be opposed against the debtor and whether the debtor's obligations have been discharged. Therefore the circumstance that the obligor and the purchaser are located outside Italy would not affect the effectiveness of the sale *vis-à-vis* the seller and his creditors or receivers.

- 3.4 Example 3:** If (a) the seller is located in Italy but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Italy recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Italy's own sale requirements?

According to the general principle of the freedom to choose foreign law, Italian courts may give effect to the choice of law made by the parties, and the seller would not need to comply with Italian requirements. However, the application of a foreign law may not prevent the Italian judge from applying overriding mandatory provisions of Italian law whenever relevant.

- 3.5 Example 4:** If (a) the obligor is located in Italy but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Italy recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Italy's own sale requirements?

According to Article 11, paragraph 1 of the Rome I Regulation, a contract between persons who are in the same country at the time of its conclusion is formally valid if it satisfies the formal requirements provided by the law which governs the substance of the same or of the law of the country where the contract is concluded. According to Article 14, paragraph 2 of Rome I Regulation, the law governing the assigned claim shall determine its assignability, the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and whether the debtor's obligations have been discharged.

- 3.6 Example 5:** If (a) the seller is located in Italy (irrespective of the obligor's location), (b) the receivable is governed by the law of Italy (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Italy recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Italy and any third party creditor or insolvency administrator of any such obligor)?

Please make reference to question 3.2 above. In this case, however, the application of foreign law may not prevent the Italian judge from applying overriding mandatory provisions of Italian law whenever relevant. Furthermore, according to Article 14, paragraph 2 of the Rome I Regulation, to recognise the effectiveness of the sale, in addition to the requirements of the law governing the receivables purchase agreement, the requirements provided by Italian law must also be satisfied.

## 4 Asset Sales

- 4.1 Sale Methods Generally.** In Italy what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

Pursuant to Article 1260 of the Italian Civil Code, a creditor may assign its receivables without the debtor's consent, subject to certain limitations deriving from the specific characteristics of the receivables.

The receivables are transferred by means of an agreement between the seller and the purchaser.

The terms generally used to identify this method of selling receivables are "transfer" or "assignment".

- 4.2 Perfection Generally.** What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

According to Article 1264 of the Italian Civil Code, the assignment is valid and binding as against the assigned debtor if the debtor has accepted the assignment or has received notice thereof.

In respect of subsequent good faith purchasers, Article 1265 of the Italian Civil Code provides that if the same receivable has been the object of more than one assignment, the first assignment in respect of which the debtor has been notified or which the debtor has accepted at a certain date under the law (*data certa*), shall prevail.

Different rules apply if the assignment of receivables takes place in the context of a securitisation transaction. Under the Securitisation Law the sale of receivables is perfected upon registration of the transfer agreement with the Companies' Register and publication of a notice of the assignment in the Official Gazette. Moreover, pursuant to Article 4, paragraph 1 of the Securitisation Law, assignments of trade receivables (as defined under Law No. 52 of 1991, hereafter the "Law 52" or the "Factoring Law") may be perfected through (i) the publication in the Official Gazette of the Republic of Italy of a simplified notice of assignment containing only the indication of the originator, the purchaser and the transfer

date, or (ii) if the parties so elect, by payment at a certain date in accordance with Article 5, paragraphs 1, 1-*bis* and 2 of Law 52. For the purposes of establishing a “certain date”, it is sufficient to annotate the cash on the relevant account of the transferor, in accordance with Article 2, paragraph 1, letter (b) of Legislative Decree No. 170 of 21 May 2004.

---

#### 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

---

In order to assign Promissory Notes the seller is required to endorse them in favour of the purchaser.

The transfer of mortgage loans is made by way of a transfer agreement. However, in order to perfect the transfer of the mortgage security *vis-à-vis* third parties, Article 2843 of the Italian Civil Code provides that the assignment must be annotated at the margin of the mortgage registration in the competent land register offices.

The modalities of the transfer of debt securities may vary depending on the particular characteristics of the debt securities to be assigned.

Under Italian law, debt securities may take the form of registered securities, bearer securities or order securities. In addition, further to Legislative Decree No. 58 of 24 February 1998 (“**Financial Act**”), financial instruments, including debt securities, which are negotiated in the market, are issued in dematerialised form. According to Article 83-*bis* and subsequent articles of the Financial Act, such instruments must be held and managed by centralised management companies (*società di gestione accentrata*). Pursuant to Article 86 of the Financial Act, the owner of dematerialised securities may, through the depositary, and in accordance with the modalities set out in the Financial Act, transfer such securities by requesting a transfer of a corresponding quantity of securities of the same kind, which are deposited with the same centralised management company.

In general terms, registered securities are transferred by means of the double annotation mechanism (*doppia intestazione*) on the issuer register and on the certificate (please refer to Article 2021 of the Italian Civil Code).

Bearer instruments are transferable by delivery, so the holder is entitled to exercise the rights mentioned therein upon presentment of the instrument (please refer to Article 2003 of the Italian Civil Code).

Order securities (*titoli all'ordine*) are transferred by endorsement (please refer to Article 2011 of the Italian Civil Code and to the comments set out herein in respect to promissory notes).

The sale of consumer loans does not require specific formalities.

---

#### 4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

---

With regard to the first question, please make reference to question 4.2 above. In general terms, the consent of the debtor is not required.

(a) If the contract does not expressly regulate the assignment, general principles apply according to which a creditor may freely assign receivables, provided that the receivables do not have a strictly personal character or that the transfer is not forbidden by law.

(b) If the contract expressly prohibits assignment, the receivables cannot be transferred without the debtor's consent.

In relation to the last question, there are benefits in giving notice of the assignment to the obligors. This is because, as a general rule, pursuant to Article 1248, paragraph 2, of the Italian Civil Code, the assigned obligors are entitled to exercise the right of set-off only in relation to obligations of the seller which have arisen before the date on which the debtors have been served notice of the assignment, and the transfer of the receivables has therefore been made enforceable (*opponibile*) against them.

---

#### 4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

---

In relation to the first question, please make reference to question 4.2 above. In general terms, according to Article 1264 of the Italian Civil Code, the assignment is valid and binding against the assigned debtor and other third parties if the debtor has accepted the assignment or has received notice thereof.

There is no specific time limit for the notice to be delivered to obligors but, according to Article 45 of Royal Decree No. 267 of 16 March 1942 (“**Italian Bankruptcy Law**”), the assignment of receivables shall be binding on the bankruptcy receiver if it was perfected prior to the time when the seller became insolvent. However, the assignment may be revoked, if the bankruptcy receiver is able to prove that the purchaser was aware, or should have been aware, of the insolvency of the seller, and the assignment contract was entered into during the suspect period. Please note that if the receivables are transferred in the context of a securitisation transaction the suspect period term provided under Article 67 of Italian Bankruptcy Law is reduced from six to three months.

Notice mechanics apply to all types of receivables, future ones included. In case of existing receivables, in respect of which an agreement has already been signed, reference should be made to the initial notice delivered at the time of the conclusion of that agreement. In case of future receivables, in respect of which no agreement has been concluded yet, the notice should be delivered only when these receivables arise.

---

#### 4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that “None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]” be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says “This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]” (i.e., the restriction does not refer to rights or obligations)?

---

Despite the existence of a restriction of assignment provision in the

receivables contract, the transfer of receivables by the seller to the purchaser would be valid but, without the debtor's consent it would not be enforceable against the same. Please make reference to question 4.7 below.

The result is different if the restriction is aimed at prohibiting the assignment of the agreement. In this case, the restriction provision would not prevent the transfer of the receivables because it does not relate to seller's rights and obligations under the agreement.

---

**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Italy? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Italy recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

---

Italian law provides some express prohibitions in respect of the sale of receivables. For instance, the sale of receivables of a strictly personal character is forbidden. In case of violation of the prohibitions provided by law, an Italian court may declare the invalidity of the assignment.

The parties to an agreement may agree that the receivables arising thereunder cannot be assigned to third parties. In such a case, if the seller sells the receivables without the debtor's consent, the assignment of receivables is valid and effective against the debtor, unless evidence is given that the purchaser was aware of the prohibition. In such a case the seller is liable for breach of contract *vis-à-vis* the debtor and shall indemnify the debtor for any damages incurred by it.

Certain limitations are also provided in case of receivables against public entities, arising from public contracts which have not been completely performed.

In the context of the sale of the going-concern, the assignment of receivables relating to the going-concern, even in the absence of notification to the debtor or its acceptance, is valid and effective against third parties from the date of registration with the competent Companies Register of the notice of assignment of the receivables.

---

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

---

According to general principles of Italian law, the object (*oggetto*) of a contract needs to be identified or identifiable (please refer to Article 1346 of the Italian Civil Code). In this regard, a transfer contract must identify the receivables or, at least, shall provide sufficient criteria allowing receivables to be identified. There is no specific information that has to be given mandatorily. However, pursuant to Article 1262 of the Italian Civil Code, the assignor is obliged to deliver the documents evidencing the receivables in his possession to the assignee.

The Securitisation Law provides for a specific set of rules in respect of the assignment of receivables. In particular, if the receivables to be transferred in the context of a securitisation transaction are more than one, they need to be transferred "*in blocco*".

The definition of receivables identifiable "*in blocco*" is provided in the Bank of Italy regulations (*istruzioni di vigilanza*), as amended and supplemented from time to time, issued by the Bank of Italy in relation to Article 58 of the Banking Law (which is expressly referred to in Article 4 of Law 130). In particular, legal relationships identifiable "*in blocco*" are defined as "credits, debts and contracts which have a common element of identification; such element may consist of the technical form, the economic sector of destination, the type of counterparty, the geographical area or any other element which allows identification of the relationship transferred "*in blocco*".

Article 4 of the Securitisation Law, as amended by the *Destinazione Italia Decree*, provides the possibility to realise assignments of trade receivables, as defined by Article 1 of Law 52, in the context of a securitisation transaction even if they cannot be identified "*in blocco*".

---

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

---

According to the interpretation criteria set forth under Article 1362 and subsequent articles of the Italian Civil Code, courts shall apply the principle according to which the intent of the parties shall always prevail over any other aspects.

According to Article 1267 of the Italian Civil Code, the seller may guarantee to the purchaser the obligations of the debtor. This would impair the 'without recourse' nature of the sale.

The seller may act as servicer or as interest rate swap provider, or may be granted with an option to repurchase part of the receivables, without impairing the true sale and the 'without recourse' nature of the sale.

The features above may have an effect on the accounting treatment of the sale.

---

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

---

Yes. The parties may freely determine the contents of the contract within the limits imposed by law and provided that the contract is directed to achieve interests which are worth protecting according to the Italian legal system.

In the context of securitisation transactions, revolving assignments are expressly admitted. Pursuant to Article 2, paragraph 3, e) of the Italian Securitisation Law the special purpose vehicle may reinvest the cash flows that are not immediately used for paying principal on the issued bonds in further receivables.

Moreover, continuous sales of receivables may take place in the context of factoring transactions according to Article 1 of Law 52.

For the application of such law, the following requirements need to be fulfilled: (i) the assignor must be an entrepreneur; (ii) the assigned receivables must arise from contracts entered into by the assignor in the context of its professional activity; and (iii) the assignee must be a bank or a financial institution having as its sole corporate purpose that of carrying out factoring transactions.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?**

The sale of future receivables is allowed in Italy subject to the condition that the source of the assigned receivables existed as of the date of the sale and provided that any such sale would become effective only upon the future receivables coming to existence.

In this context please also refer to Article 1 of the Italian Securitisation Law, which expressly authorises the assignment of present and future receivables in the context of securitisation transactions.

Furthermore and according to Article 3 of the Factoring Law, assignment of future receivables is authorised, provided that the contracts from which such future receivables will arise are executed within 24 months from the date of the relevant assignment agreement.

If the receivables have not yet come into existence as of the date of the declaration of bankruptcy of the seller, then the commitment to sell any receivables arising after the insolvency of the seller would be ineffective *vis-à-vis* the bankruptcy receiver and third parties generally.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

Pursuant to Article 1263 of Italian Civil Code, by effect of the assignment, the receivables are transferred to the assignee together with any privileges, real or personal guarantees, and other related security.

Certain formalities are required by Italian law for the effectiveness of the transfer of certain security interest. In this respect please consider, by way of example, the formalities required by the Italian Civil Code in respect of mortgages (see question 4.3 above).

As a consequence of the application of Article 4 of the Securitisation Law to the assignment of receivables, no re-registration of the mortgages, nor annotation or transfer of the security interests, guarantees, privileges and priority rights supporting the receivables and all other rights, benefits and accessories pertaining thereto, is required in order for them to be enforceable by the purchaser in its own name.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

Pursuant to the general rule set forth under Article 1248 of the Italian Civil Code, if the obligor has accepted purely and simply the sale that the lender has made of his claim to a third party, he may not raise against the purchaser the right of set-off which he could have raised against the seller. If the sale has not been accepted by the debtor but it has been notified to him, the debtor may not raise against the purchaser any right of set-off in respect of receivables arising after the date on which the debtor has been served notice of the assignment, and the transfer of the receivables has therefore been made enforceable (*opponibile*) against him.

In case of transfer of consumer loans, pursuant to the Consumer Code, the consumer is entitled to raise against the purchaser the same exceptions it could have raised against the seller, including, as an exception to the rules set out in Article 1248 of the Italian Civil Code, any right of set-off.

With respect to any sale of receivables perfected in the context of a securitisation transaction, the general rule set forth under Article 1248 of the Italian Civil Code shall apply. Pursuant to Article 4, paragraph 2 of the Securitisation Law, from the date of publication of the notice of assignment in the Official Gazette of the Republic of Italy or from the certain date of the payment of the purchase price, the relevant debtors cannot exercise any right of set-off between receivables purchased by the SPV and receivables owed by such debtors to the originator which arose after such date.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Italy to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

This is not applicable.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Italy, and for such security interest to be perfected?**

This is not applicable.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Italy to grant and perfect a security interest in purchased receivables governed by the laws of Italy and the related security?**

This is not applicable.

**5.4 Recognition.** If the purchaser grants a security interest in receivables governed by the laws of Italy, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Italy or must additional steps be taken in Italy?

According to general principles of Italian private international law, security interests in receivables shall be deemed as a perfected security in Italy, even if they are regulated under the laws of a third country, upon the condition that the relevant formalities provided under Italian law are fulfilled.

The security interest in the receivables perfected under a foreign law would be recognised as a valid and perfected security if the granting and the formalities of such security is compliant with such foreign law and is not in breach of mandatory provisions of Italian law.

**5.5 Additional Formalities.** What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Please make reference to question 4.3 (*Perfection of Promissory notes, etc.*) above.

**5.6 Trusts.** Does Italy recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?

Trusts are recognised and enforced in Italy by virtue of the Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition, which was ratified pursuant to Italian Law No. 364 of 16 October 1989, which came into force on 1 January 1992. As there is no domestic legislation relating to trusts, trusts can only be established in Italy in accordance with The Hague Convention and subject to a foreign governing law.

The separation between collections received by the seller and corporate assets of the purchaser is a mandatory requirement for the special purpose vehicle pursuant to Article 3 of the Italian Securitisation Law.

In addition to the above, the Destinazione Italia Decree has introduced some provisions under the Securitisation Law aimed at strengthening the securitisation structure and providing for the possibility for the purchaser to open segregated accounts.

Pursuant to Article 3, paragraph 2-ter of the Securitisation Law, the servicer and the sub-servicer may open separate accounts with banks, into which any amounts collected on behalf of the SPV are credited, even on a non-exclusive basis. No action by creditors of the servicer are permitted with respect to sums credited to such accounts – which shall be fully repaid to the SPV on behalf of which the collections were made without the need to wait for distribution of such sums – other than with respect to any excess amounts received. Therefore, if the seller is appointed as servicer or sub-servicer, the collections shall be made on a bank account opened in accordance with Article 3, paragraph 2-ter of the Securitisation Law.

**5.7 Bank Accounts.** Does Italy recognise escrow accounts? Can security be taken over a bank account located in Italy? If so, what is the typical method? Would courts in Italy recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Italy?

The most common method to constitute an escrow over a bank account in Italy is the creation of a pledge over the sums credited into such accounts. According to Article 51 of Law No. 218 of 31 May 1998, an Italian court would recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Italy to the extent that all the formalities provided under Italian law for the creation of a security over an account are fulfilled (please refer also to Article 55 of the same law).

**5.8 Enforcement over Bank Accounts.** If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Pursuant to Italian law, upon the occurrence of an enforcement event, the secured creditor is entitled to withhold any amount standing to the credit of each of the pledged accounts as of the date of the enforcement, applying it to the complete discharge of the secured obligations, provided that any excess of the pledged credit balance shall be discharged and made available to the pledgor.

Notwithstanding the above, upon the opening of a bankruptcy proceeding in respect of the pledgor, the lenders, even if they are privileged creditors, shall submit their recovery credit request to the bankruptcy procedure and could be satisfied only at the conclusion of the latter.

Please note that under a special legislation (i.e. Legislative Decree of 21 May 2004, No. 170) applicable in certain circumstances to pledge over bank accounts, even if a bankruptcy proceeding has been opened in respect of the pledgor, the lenders may withhold any amount standing to the credit of each of the pledged accounts and apply such amounts in discharging the secured obligations, informing the pledgor and the bodies of the insolvency proceedings in writing about the manner of enforcement and the relevant proceeds.

**5.9 Use of Cash Bank Accounts.** If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Until the occurrence of an enforcement event, the pledgor may be contractually entitled to use amounts deposited on the pledged accounts in accordance with the terms and conditions set forth under the relevant facility documents.

## 6 Insolvency Laws

**6.1 Stay of Action.** If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Italy's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

The Italian Bankruptcy Law does not provide for an automatic stay clause on the purchaser.

The bankruptcy receiver is empowered, among other things, to manage and liquidate the assets and, for such purpose, he is entitled to institute any action to set aside and revoke the transactions carried out during the so-called "suspect period". Until any such sale is revoked, the bankruptcy receiver has no power to stay collections.

**6.2 Insolvency Official's Powers.** If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?

Under Italian law no specific measures are provided to prohibit the purchaser's exercise of rights, in the context of an insolvency procedure.

**6.3 Suspect Period (Clawback).** Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Italy for (a) transactions between unrelated parties, and (b) transactions between related parties?

According to Articles 64 and 65 of the Italian Bankruptcy Law, the following transactions are void *vis-à-vis* creditors (and the declaration that the transaction is void is not subject to any terms of prescription): (a) transactions without consideration for the benefit of the bankrupt which were carried out in the two years prior to the declaration of bankruptcy (including security rights given in respect of third party debts not contemporaneously created); and (b) payments of debts which expire on the date of the declaration of bankruptcy or thereafter, if said payments have been made in the two years prior to the declaration of bankruptcy.

Pursuant to Article 67 of Italian Bankruptcy Law, the clawback action may be successfully filed and pursued by the bankruptcy receiver in connection with the following transactions, unless the counterparty proves that it had no knowledge of the state of insolvency of the individual entrepreneur or corporation that was declared insolvent:

- (a) transactions concluded in the year prior to the declaration of insolvency in which the obligations performed or assumed by the debtor exceed by more than one-quarter what the debtor received;
- (b) payment of overdue monetary debt obligations where payment was not made with money or other normal means of payment, if made in the year prior to the declaration of insolvency; and

- (c) pledges, securities and mortgages judicially imposed or voluntarily created in the six months prior to the declaration of insolvency in respect of overdue obligations.

Moreover, payment of liquid and enforceable debts, transactions for consideration and transactions where security rights are given in respect of contemporaneously created debts (including debts towards third parties) which are effected in the six months prior to the declaration of insolvency shall be subject to the clawback action, if the bankruptcy receiver can prove that the counterparty was aware, or should have been aware, of the state of insolvency.

With reference to the above, in the context of a securitisation transaction, the exemption already provided for by Article 4 of the Securitisation Law from the application to special purpose vehicles of the clawback provisions under Article 67 of Italian Bankruptcy Law, in respect of payments made to them by the underlying debtors, has been expressly extended also to Article 65 by the Destinazione Italia Decree.

**6.4 Substantive Consolidation.** Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Under Italian law, the bankruptcy receiver may not consolidate the assets and liabilities of the purchaser with those of the seller and its affiliates.

**6.5 Effect of Proceedings on Future Receivables.** If insolvency proceedings are commenced against the seller in Italy, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

- (a) If the sale of receivables has not yet become effective before the declaration of insolvency, the transfer shall not take place after such a declaration.
- (b) Please make reference to question 4.9 above.

**6.6 Effect of Limited Recourse Provisions.** If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?

Limited recourse provisions would be interpreted as a condition to the existence and to the amount of the relevant obligation.

## 7 Special Rules

**7.1 Securitisation Law.** Is there a special securitisation law (and/or special provisions in other laws) in Italy establishing a legal framework for securitisation transactions? If so, what are the basics?

The Securitisation Law recognises and regulates securitisation transactions in Italy.

The basic aspects of such law are as follows:

- (i) securitisation law applies to securitisations carried out by way of non-gratuitous assignment of certain monetary receivables to special purpose companies (SPV), which issue



notes to be repaid using the cash flow arising from collections in respect of the receivables;

- (ii) the Destinazione Italia Decree has extended the application of the Securitisation Law to the securitisation of receivables realised by the SPV through the subscription and acquisition of bonds and similar securities, with the exception of securities representing the capital stock, hybrid securities and convertible bonds;
- (iii) if the receivables to be transferred in the context of a securitisation transaction are more than one, they need to be transferred *in blocco*, with the exception of trade receivables that may be transferred even if they cannot be identified *in blocco*;
- (iv) all the receivables purchased by the issuer and collections in respect thereof which are paid after the publication of the notice of assignment in the Official Gazette and the issue of the notes are segregated from all other assets of the issuer and may not be attached or foreclosed by any party which is not a holder of the notes;
- (v) SPVs may open segregated accounts with the account bank or the servicer. Sums arising out of the collection constitute separate assets in all respects from that of the depositary bank and from other depositors. Such sums are fully repaid to the SPV on behalf of which the collections were made, in accordance with the contractual terms and without the need to wait for distribution of such sums;
- (vi) the servicer and the sub-servicer may open separate accounts with banks, into which any amounts collected on behalf of the SPV are credited, even on a non-exclusive basis. No actions by creditors of the servicer are permitted with respect to sums credited to such accounts – which are fully repaid to the SPV on behalf of which the collections were made without the need to wait for distribution or other refunds of such sums – other than with respect to any excess of amounts received and due to the SPV;
- (vii) in the event of bankruptcy of the assigned debtors the rules in relation to clawback actions, pursuant to Articles 67 and 65 of the Italian Bankruptcy Law, do not apply to payments made by the assigned debtors to the issuer; and
- (viii) in the event of bankruptcy of the assignor, the one-year and six-month terms for the exercise of the clawback action pursuant to Article 67 of Italian Bankruptcy Law are reduced to six months and three months respectively.

**7.2 Securitisation Entities. Does Italy have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

- (a) Pursuant to Article 3, paragraph 1, of the Securitisation Law, securitisation companies shall have as their sole corporate purpose the carrying out of one or more securitisation transactions. With reference to the segregation of assets, please refer to question 7.1 (ii) above.
- (b) SPVs must be incorporated as a joint stock company or limited liability company (please refer to Article 3, paragraph 3, of the Securitisation Law).
- (c) Further, requirements for shareholder status are provided under Article 19 of the Italian Banking Act. Directors shall meet the honour, professionalism and independence requirements provided under Articles 25 and 26 of the Italian Banking Act.

**7.3 Limited-Recourse Clause. Will a court in Italy give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

Italian courts may give effect to a limited recourse provision, even if the contract's governing law is the law of another country, provided that such provision does not constitute a limitation of liability prohibited under Article 2740, paragraph 2 of the Italian Civil Code. Please make reference to question 6.6 above.

**7.4 Non-Petition Clause. Will a court in Italy give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

(a)-(b) An Italian court may give effect to a non-petition clause (pursuant to which a creditor of the issuer agrees not to institute against, or adhere in instituting against, the issuer any bankruptcy, reorganisation, arrangement, insolvency or liquidation proceedings or join as a party any of these proceedings already instituted) only to the extent that it would give rise to the right to claim for damages in case of breach but, in general, it would not prevent the petition filed in breach of such provision from being deemed to have been validly filed.

**7.5 Priority of Payments "Waterfall". Will a court in Italy give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

The order of priority of payments contained in contractual provisions, under which, *inter alia*, some parties accept to subordinate their rights to the rights of other creditors of the issuer, would be valid among the parties under Italian law. In any event, should the receiver or bankruptcy trustee of the debtor disregard the subordination provisions contained in waterfall, it should pay all amounts due to the creditors (or their delegates), who might then have to comply with the provisions regarding priority of payments.

**7.6 Independent Director. Will a court in Italy give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

In general, resolutions that have not been adopted in compliance with the by-laws may be challenged by the board of auditors and by the directors who were not present or dissented (i.e. an independent director who has not expressed his vote) within ninety days from the date of the resolution (Article 2388, paragraph 4, of the Italian Civil Code). With reference to insolvency procedures, please note that directors are obliged to comply with the duties provided by the Italian Bankruptcy Law.

## 8 Regulatory Issues

- 8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Italy, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Italy? Does the answer to the preceding question change if the purchaser does business with other sellers in Italy?**

In general, all companies carrying out financial activities in Italy shall be enrolled in the general register held by the Bank of Italy, pursuant to Article 106 of Italian Banking Act.

If the purchase takes place in the context of a securitisation transaction, please refer to questions 7.1 and 7.2 above.

The answer does not change if the purchaser does business with other companies.

- 8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

Pursuant to Article 2, paragraph 6 of the Securitisation Law, the entity which carries out servicing duties in favour of the securitisation company has to be a bank or a financial institution enrolled in a special register provided under Article 106 of the Italian Banking Law.

- 8.3 Data Protection. Does Italy have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

In Italy, data is to be treated in accordance with the security measures provided under Legislative Decree No. 196 of 30 June 2003 (“Data Protection Law”), which applies both to consumers and enterprises.

- 8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Italy? Briefly, what is required?**

Transactions with consumers shall be carried out by entrepreneurs in accordance with the provisions set forth in the Consumers’ Code, which provides certain rules aimed at protecting the weaker party.

- 8.5 Currency Restrictions. Does Italy have laws restricting the exchange of Italy’s currency for other currencies or the making of payments in Italy’s currency to persons outside the country?**

There are no provisions limiting the exchange of currency.

## 9 Taxation

- 9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Italy? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

As a principle, but subject to certain exceptions, no withholding tax is levied on payments of commercial receivables. However, as a general rule, the interest payments made by an Italian resident (other than an individual) to a foreign entity are subject to withholding tax. The rate can vary in relation to the location of the purchaser.

In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, a case-by-case analysis should be performed in order to determine whether or not any interest may arise.

- 9.2 Seller Tax Accounting. Does Italy require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

According to Article 101, paragraph 5 of the Italian Income Tax Code, losses on receivables are deductible as long as they derive from definite and determined elements.

In any case, such condition is satisfied if a small amount (as quantified by the same Article 101) of receivables is sold and a period of six months from the date of payment has elapsed. The conditions for the application of the deductions are met in case of de-recognition (*cancellazione*) of receivables pursuant to the relevant accounting principles.

In case of a sale of receivables without recourse, based on Italian Accounting Principle No. 15, the assigned receivables must be removed from the accounts of the seller and, for tax purposes, a taxable gain/deductible loss equal to the difference between the book value and the selling price, if any, must be recorded.

In case of a sale with recourse, the seller can either keep the receivables in the accounts or remove them mentioning the risk exposure related thereto in the memorandum accounts.

Companies required to comply with the IAS/IFRS must apply the criteria set forth by IAS 39, according to which, in case the seller retains control of the financial assets following the transfer of the receivables, such financial assets must be recognised in the seller’s accounts to the extent of the seller’s continuing involvement in the same assets. This implies that the seller continues to account the receivables also for tax implications arising therefrom.

It is worth mentioning that IAS/IFRS have been implemented in Italy through Legislative Decree No. 38 of 28 February 2005, whereby listed companies, insurance companies, banks and companies issuing debt instruments to the public must draw up the consolidated balance sheet according to the IAS as from 1 January 2005. The companies mentioned above must draw up an operating balance sheet in accordance with the IAS/IFRS from 1 January 2006.

Concerning issuers incorporated pursuant to Law 130, the Bank of Italy issued a regulation on 13 March 2012 confirming, broadly speaking, the off-balance sheet treatment of securitisation transactions done pursuant to Law 130 in the accounts of a Law 130 issuer.

From a fiscal perspective, if the seller does not remove from their books the financial assets sold, it is not entitled to deduct any capital loss arising from the sale.

---

### 9.3 Stamp Duty, etc. Does Italy impose stamp duty or other documentary taxes on sales of receivables?

---

As a rule, sales of receivables made in the context of a securitisation transaction shall be subject to registration tax (*imposta di registro*) at a fixed amount (currently EUR 200). In addition, stamp duty (*imposta di bollo*) shall apply at a fixed amount (currently EUR 16) for each four pages of the relevant document.

---

### 9.4 Value Added Taxes. Does Italy impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

---

In Italy, as a matter of principle, sales of goods or services for consideration are subject to VAT.

The sale of receivables shall be subject to VAT if carried out in the context of a financial transaction and if made for consideration; nevertheless, should that be the case, the sale would be VAT-exempt pursuant to Article 10 paragraph 1 of Presidential Decree No. 633 of 26 October 1973.

As to the services rendered by the collection agent (servicer), they are subject to Italian VAT.

---

### 9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

---

In Italy, tax liabilities are not joint and several, unless the law provides otherwise.

With regard to stamp duty and registration tax, the seller and the purchaser are jointly liable for the payment, if due.

In certain circumstances the purchaser shall be obliged to issue a VAT invoice and/or to pay the relevant VAT directly to the tax authorities if the seller fails to do so.

Pursuant to certain articles of the Italian Civil Code, general or special liens are granted to the Tax Authorities for claims for taxes and duties.

---

### 9.6 Doing Business. Assuming that the purchaser conducts no other business in Italy, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Italy?

---

In this respect a case-by-case analysis should be performed in order to determine whether or not a permanent establishment issue may arise.

In general terms the purchase of the receivables and the subsequent activities do not meet the concept of permanent establishment. However, it is worth mentioning that the recent practice of the Italian Tax Authorities is more aggressive than in the past with regard to the permanent establishment of foreign entities.

Therefore the purchaser must be careful in order to exclude any relevant relationship with the Italian territory. In this context – even on the basis of the recent jurisprudence – it is advisable to take into account the real level of autonomy of the collection agent and other subject (other than the purchaser) involved in the transaction.

**Francesco Ago**

Chiomenti Studio Legale  
Via XXIV Maggio, 43  
00187 - Rome  
Italy

Tel: +39 0646 622 729  
Fax: +39 0646 622 600  
Email: francesco.ago@chiomenti.net  
URL: www.chiomenti.net

Francesco Ago joined the firm in 1974 and became a partner in 1986. He is a business lawyer specialised in providing assistance to Italian and foreign clients in Finance (Structured Finance, Securitisations, Covered Bonds, Acquisition and Leveraged Finance, Real Estate Financing, Export Finance, Leasing and Asset Finance), Capital Markets (IPOs and other Equity Offerings, Debt Offerings, including Convertibles and Equity-linked Instruments), and Private Placements (Including to Management and Employees), Insolvency and Restructuring (Insolvency and Pre-Insolvency Proceedings and Financial Restructuring).

**Highlights**

He has assisted the main financial institutions, companies and Italian and foreign entities in complex and innovative transactions; he has assisted in respect of the legal matters in the major privatisations of the Republic of Italy, complex corporate transactions as well as the application of new schemes and legal techniques elaborated in the international financial markets in Italy.

**Education**

Graduated in Law, University of Rome, La Sapienza, 1973; admitted to the Bar, Italy, 1977; MCL, Georgetown University, Washington, D.C. (USA), 1978.

**Membership in Professional Associations**

Member of the Rome Bar (Italy).

**Languages**

Italian, English, French.

**Gregorio Consoli**

Chiomenti Studio Legale  
Via XXIV Maggio, 43  
00187 - Rome  
Italy

Tel: +39 0646 622 729  
Fax: +39 0646 622 600  
Email: gregorio.consoli@chiomenti.net  
URL: www.chiomenti.net

Gregorio Consoli joined the firm in 2002 and became a partner in 2013. He is a business lawyer specialised in providing assistance to Italian and foreign clients in structuring and documentation of debt transactions with a focus on bond issuances, structured finance transactions, securitisation of receivables, asset acquisition finance and secured lending transactions, project finance and real estate financing.

**Recent Highlights**

Since 2009, leader in the covered bonds market.

Assisted banks, financial companies and investors in relation to securitisation and asset finance transactions. Assisted major investment funds and other investors in the purchase of financial assets.

Assistance in relation to lending and other financing transactions (project financing and construction loans) including the assistance to EIB in relation to the EUR 1.8 billion financing in relation to the Brebemi project (IFLR Project Finance Deal of the Year 2013).

Assistance in relation to the issuance of hybrid bonds, high yield bonds and other capital market transactions.

**Education**

Graduated in Law, L.U.I.S.S. Guido Carli University, Rome, 2001; admitted to the Bar, Italy, 2004; Ph.D., Business Law, L.U.I.S.S. Guido Carli University, Rome, 2008.

**Membership in Professional Associations**

Member of the Rome Bar (Italy).

**Languages**

Italian, English.

**CHIOMENTI**

STUDIO LEGALE

Studio Legale Chiomenti's distinction has always been its international outlook and its Italian legal expertise. Studio Legale Chiomenti has accompanied the growth of the major Italian businesses and the continuing increase in incoming and outgoing foreign investments. The Firm today has over 300 attorneys and tax advisers and offices in Rome, Milan, Turin, London, Brussels, New York, Beijing, Shanghai and Hong Kong. Studio Legale Chiomenti provides integrated legal advice with the goals of assisting clients to clearly understand the legal variables affecting their business decisions and turning efficient legal structures into a competitive advantage. The firm's quality legal assistance has been rewarded by recognition in the specialised press and in legal sector organisations. Studio Legale Chiomenti's clients include major Italian and foreign industrial, banking, insurance, and financial groups.

The firm is the Italian correspondent firm in Lex Mundi, the primary world association of independent law firms active in over 160 countries.

# Japan



Nishimura & Asahi

Hajime Ueno

## 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

It is not necessary for the sale of goods or services to be evidenced by a formal contract, so long as there is a legally binding, effective and valid contract, whether oral or implied. Whether invoices alone would be sufficient as evidence of the existence of an enforceable debt obligation would depend on the facts of each case and would be determined by the courts. A contract can be determined to exist from evidence including: the behaviour of the parties; past relationships; or commercial customs.

**1.2 Consumer Protections. Do Japanese laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

(a) There are usury laws that restrict the rate of interest on loans (which can include various forms of credit extension), namely the Interest Rate Restriction Law (the “IRR Law”) and the Law for Control of Acceptance of Contributions, Money Deposits and Interest, Etc. (the “Contributions Law”). The IRR Law provides that a contractual clause providing for interest on a loan at a rate exceeding a certain prescribed rate (described below) is null and void with respect to the portion exceeding such rate. Significantly, fees, default interest and other amounts received by a lender in connection with the loan will be treated as interest payments for the purpose of calculating the rate of interest.

Principal	Maximum Rate of Interest ( <i>per annum</i> )
Less than 100,000 Yen	Equal to or under 20 per cent
From 100,000 Yen to 1,000,000 Yen	Equal to or under 18 per cent
1,000,000 Yen or more	Equal to or under 15 per cent

Under the current Contributions Law, no person in the money lending business may charge interest at a rate exceeding 20 per cent *per annum*. Charging or receiving interest at a rate in excess of such rate is subject to criminal penalties. Similarly with the IRR Law, in calculating the interest rate, any payment that the lender receives in connection with the lending will be deemed to be part of the interest payment. The Moneylenders’ Law is a regulatory statute governing non-bank finance companies. The Moneylenders’ Law requires registration of those who engage in the business of lending money, and regulates various lending practices, including marketing and collection practices, as well as the rate of interest charged on loans extended by moneylenders. Lastly, a prohibitively high rate of interest on (or interest on late repayments of) credit or other kinds of receivables may possibly be determined as void due to public policy reasons pursuant to the general Civil Code.

(b) There is a statutory right to interest on late payments; specifically, the general Civil Code provides that, unless otherwise agreed by the parties, interest will accrue following a late payment of a monetary obligation at a rate of 5 per cent *per annum* (6 per cent per annum, in cases of monetary obligations arising out of commercial conduct, as provided under the Commercial Code).

(c) For certain consumer contracts such as instalment sales agreements (i.e., sale and purchase agreements for which payments of purchase amounts are in instalments) in respect of certain types of products (including, without limitation, life insurance policies purchased outside of the insurance company’s premises), the Instalment Sales Law (the “ISL”) provides consumers with rights to cancel contracts during the cooling off period mandated by the law.

(d) The ISL also provides consumers with protection against provisions providing for the business operator’s right to terminate the contract or to declare that the consumer’s obligation to pay all unpaid instalments has become immediately due and payable even if the consumer does not pay an instalment, unless the business operator makes a demand against the consumer in writing to pay the instalment within a period prescribed in such written demand (which must be a reasonable period and may not be less than 20 days from such written demand) and the consumer fails to so pay the instalment within such period. In addition, the Consumer Contracts Law (the “CCL”) provides, among other things, consumers with rights to rescind consumer contracts, for example, if the consumer had mistakenly manifested his/her intention to enter into the contract as a result of any misrepresentation by the business operator (who is the counterparty to the consumer contract) with respect to material matters such as quality, purpose and other characteristics of goods, rights, services, etc., of such consumer contract.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

As a matter of practice, when the government or a governmental agency enters into a receivables contract, the contract would likely include a provision that prohibits transfers/assignments of rights thereunder by the counterparty without the prior consent of the government or the governmental agency, as the case may be. Also, such receivables contract may include a provision requiring that no third party be appointed as a collection servicer without the prior consent of the government. Therefore, although there is no specific statutory requirement, consent of the government or the governmental agency would likely be contractually required for the sale and/or collection of receivables.

## 2 Choice of Law - Receivables Contracts

**2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Japan that will determine the governing law of the contract?**

The Application of Laws (General) Act (the “ALGA”) which came into effect on 1 January 2007, provides that if the parties to a contract do not specifically agree on a choice of law, the law of the jurisdiction having the closest relevance with the contract will govern the contract. However, it is generally assumed that a Japanese court will still follow a Supreme Court ruling, made prior to the introduction of the Act, to the effect that courts should first determine if the parties had implicitly agreed on the choice of law before applying the principle above. The Act also stipulates that if the contracting parties had not specifically agreed on a choice of law, and if the contract obligates a party to undertake a characteristic performance, then the law of such party’s residence (or primary office) will be presumed to be the law of the jurisdiction having the closest relevance.

**2.2 Base Case. If the seller and the obligor are both resident in Japan, and the transactions giving rise to the receivables and the payment of the receivables take place in Japan, and the seller and the obligor choose the law of Japan to govern the receivables contract, is there any reason why a court in Japan would not give effect to their choice of law?**

In such a case, it would be very unlikely for a court not to uphold the parties’ choice of law, at least judging from the published court decisions; provided, however, that if the subject of the receivables contract is a movable, the ownership of which is to be registered, and which is located outside Japan, then under the ALGA, the law of the jurisdiction in which the movable is located will govern the matters relating to the transfer of ownership.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Japan but the obligor is not, or if the obligor is resident in Japan but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Japan give effect to the choice of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

Under the ALGA, parties to a contract are allowed to choose the governing law to be applied to their contractual obligations. Accordingly, the seller and the obligor may choose a foreign law to govern the receivables contract. However, if the application of the chosen law would result in a situation that would be against the public welfare or interests of Japan, then a court would not apply the chosen law as the governing law. In addition, different sets of rules under the ALGA are applied to consumer contracts to protect the interests of consumers. For example, if the obligor is a consumer (as defined in the ALGA) and the seller is a business operator (also as defined in the ALGA), then the consumer (i.e., the obligor) may demand that the law of the jurisdiction in which he/she resides be the governing law.

**2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Japan?**

Yes. The Convention came into effect in Japan on 1 August 2009.

## 3 Choice of Law - Receivables Purchase Agreement

**3.1 Base Case. Does Japanese law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Japanese laws or foreign laws)?**

The ALGA does not specifically require that the sale agreement/contract under which receivables are sold be governed by the same law as the law governing the receivables themselves. However, under the ALGA, the “effects of a transfer” in terms of a transfer of a receivable (as opposed to contractual agreements stated in the sale agreement or surrounding the sale) against the obligor and other third parties are to be governed by the law governing the receivable itself, as noted in question 3.2 below.

**3.2 Example 1: If (a) the seller and the obligor are located in Japan, (b) the receivable is governed by the law of Japan, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Japan to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Japan, will a court in Japan recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?**

Under the ALGA, the effects of a transfer of a receivable against the obligor and other third parties are governed by the law governing the receivable itself. Therefore, a Japanese court would determine the effects of the transfer resulting from the sale of the receivables (e.g., whether the receivables are effectively transferred) on the

basis that Japanese law is the governing law. Thus, in this “Example 1” case, courts in Japan will recognise the sale as being effective against the seller, the obligor and other third parties.

**3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Japan, will a court in Japan recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?**

The ALGA does not take into account the requirements of the law of the obligor’s country or the purchaser’s country; and as noted in question 3.2 above, the effects of a transfer of a receivable against the obligor and other third parties are governed by the law governing the receivable itself.

**3.4 Example 3: If (a) the seller is located in Japan but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Japan recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Japanese own sale requirements?**

As noted in question 3.2 above, the effects of a transfer of a receivable against the obligor and other third parties are governed by the law governing the receivable itself; therefore, under the ALGA, the sale of the receivable is governed by the law of the obligor’s country. Thus, while there is no need to comply with Japan’s own sale requirements, a court in Japan will not recognise the sale as being effective against the seller and other third parties, unless the requirements under the law of the obligor’s country are complied with. However, this does not necessarily mean that the choice of law under the sale agreement will immediately be deemed void, since the effects of rights and obligations arising directly out of the sale agreement (e.g., whether an act of the seller would constitute a breach of contract giving rise to an indemnification obligation of the seller) would be determined in accordance with the law chosen as the governing law under the agreement, subject to the public welfare or interest doctrine described in question 2.3 above.

**3.5 Example 4: If (a) the obligor is located in Japan but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Japan recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Japanese own sale requirements?**

As noted in question 3.2 above, the effects of a transfer of a receivable against the obligor and other third parties are governed by the law governing the receivable itself. Thus, in this “Example 4” case, courts in Japan will recognise the sale as being effective against the seller, the obligor and other third parties without the need to comply with sale requirements under Japanese law.

**3.6 Example 5: If (a) the seller is located in Japan (irrespective of the obligor’s location), (b) the receivable is governed by the law of Japan, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Japan recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Japan and any third party creditor or insolvency administrator of any such obligor)?**

As noted in question 3.2 above, the effects of a transfer of a receivable against the obligor and other third parties are governed by the law governing the receivable itself; therefore, the sale of the receivable needs to be, under the ALGA, governed by the law of Japan. Thus, unless the sale is governed by the law of Japan, a court in Japan will not recognise the sale as being effective against the seller and other third parties. However, this does not necessarily mean that the choice of law under the sale agreement will immediately be deemed void, since the effects of rights and obligations arising directly out of the sale agreement (e.g., whether an act of the seller would constitute a breach of contract giving rise to an indemnification obligation of the seller) would be determined in accordance with the law chosen as the governing law under the agreement, subject to the public welfare or interest doctrine described in question 2.3 above.

## 4 Asset Sales

**4.1 Sale Methods Generally. In Japan what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

Under the current system, the customary method for a seller to sell receivables is to enter into a sales agreement with the purchaser in which the subject receivables need to be specified, and the sale be perfected through one of the methods described in question 4.2 below. In some cases, the continuous sales method is adopted. The terminology in the Japanese language is “*baibai*” (a simple translation would be “sale”) or “*joto*” (a simple translation would be “assignment”).

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

The perfection of a sale of receivables is generally made by one of the following methods:

- (a) the seller delivering notice to the obligors, or the seller or purchaser obtaining consent from the obligors, which notice or consent must bear an officially certified date (*kakutei-hizuke*) by means prescribed under law in order to perfect against third parties; or
- (b) where the seller is a corporation, the seller registering the sale of receivables in a claim assignment registration file in accordance with the Law Prescribing Exceptions, Etc., to the Civil Code Requirements for Perfection of Transfers of Movables and Receivables (the “Perfection Exception Law”).

Provided one of the methods noted above is duly taken, there are no additional formalities required for perfection against subsequent purchasers.

#### 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

##### (i) Promissory notes

Under the Promissory Notes Law, the general method of sale and perfection against the obligor and third parties is by the seller endorsing the promissory notes and delivering the same to the purchaser.

##### (ii) Consumer loans

While there are no additional or different requirements for perfection of sales of consumer loans, see question 8.3 for regulations regarding sales of loans extended by moneylenders regulated under the Moneylenders' Law (nevertheless, the regulations apply not only to consumer loans but to all loans (including mortgage loans) extended by a moneylender).

##### (iii) Mortgage loans

For the perfection of a sale of a loan secured by a hypothec (*teito-ken*) or umbrella hypothec (*ne-teito-ken*), the following will be necessary as additional requirements to those described in questions 4.1 and 4.2:

###### (a) In case of a loan secured by a hypothec

In order for the hypothec to be concurrently transferred to the purchaser with the sale of a loan (secured by the hypothec), no additional action is necessary other than the requirement for the valid and effective sale of the loan itself (*zuihansai*). For perfection of the transfer of the hypothec as a result of the sale of the loan, the transfer of the hypothec needs to be registered through a supplemental registration (*fuki-toki*) in the real estate registry (however, such registration is generally believed to be unnecessary to perfect against a third party who is a transferee of the hypothec together with the loan secured thereby).

###### (b) In case of a loan secured by an umbrella hypothec

In order for a loan to be transferred together with an umbrella hypothec (or the hypothec resulting from crystallisation of the umbrella hypothec), and for such transfer to be perfected, either of the following methods needs to be used:

- (x) For an effective transfer of an umbrella hypothec without crystallisation, the obligor or any other party who created the umbrella hypothec must consent to the transfer (and consent to amend the scope of obligations secured by the umbrella hypothec might also be necessary depending on the terms thereof). For perfection of the transfer of an umbrella hypothec without crystallisation, the transfer needs to be registered through a supplemental registration (*fuki-toki*) in the real estate registry.
- (y) For an effective transfer of a loan with a hypothec resulting from the crystallisation of an umbrella hypothec that originally secured the loan, the obligations secured by such umbrella hypothec need to be crystallised (*kakutei*) in accordance with the general Civil Code prior to the sale becoming effective (if not crystallised, and if the consent described in (x) above is not obtained, the relevant loan will be transferred as an unsecured loan). For

perfection of the transfer of the hypothec (occurring together with the transfer of the loan secured thereby) resulting from the crystallisation, the requirement described in (a), above, applies.

##### (iv) Marketable debt securities

While there is no legal concept equivalent to “marketable debt securities” or any legal distinction between marketable securities and non-marketable securities under Japanese law, we will focus on the sale and perfection of Japanese government bonds (“JGBs”) and bonds issued by corporations. The requirements for sale and perfection of these securities depend on their form.

##### (a) In case of JGBs

- (A) If in bearer form with physical certificates (*mukimei kokusai shouken*)

For effective sale and perfection, the seller and purchaser must agree to sell and purchase the JGBs and the seller should deliver the physical certificates to the purchaser. In general, there is no prohibition on the transfer of bearer JGBs.

- (B) If registered JGBs (*touroku kokusai*)

For perfection against third parties as well as the government, the transfer needs to be registered in the JGB registry at the Bank of Japan in accordance with the Law Regarding Japanese Government Bonds and rules promulgated thereunder.

- (C) If in book-entry form under the Transfer Law (*furikae kokusai*)

For sale and perfection against the government and third parties, the amount of the JGBs assigned to the purchaser as a result of the sale needs to be entered into the purchaser's account book in accordance with the Law Concerning Book-Entry Transfer of Corporate Bonds, Etc. (the “Transfer Law”).

##### (b) Corporate Bonds

- (A-1) If in bearer form with physical certificates (*mukimei shasaiken*)

Under the Corporations Act, no transfer will be effected without the physical delivery to the purchaser of the certificate in case of certificated bonds.

- (A-2) If in non-bearer form with physical certificates (*kimei shasaiken*)

The same as (A-1) above; under the Corporations Act, no transfer will be effected without the physical delivery to the purchaser of the certificate in case of certificated bonds. In addition, in cases of non-bearer bonds issued pursuant to the Corporations Act, in order to perfect the transfer against third parties and against the issuer company, the purchaser's name and address need to be recorded in the bond registry (*shasai genbo*) in accordance with the Corporations Act.

- (B) Book-entry bonds under the Transfer Law (*furikae shasai*)

For sale and perfection against the issuer company and third parties, the amount of the book-entry bonds assigned to the purchaser as a result of the sale needs to be entered into the purchaser's account book in accordance with the Transfer Law.



**4.4 Obligor Notification or Consent.** Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

Where the receivables contract prohibits a sale of the receivables thereunder without the consent of the obligor, the consent of the obligor will be required. Therefore, in such a case, naturally, a notification to the obligors would be required as a matter of fact. Otherwise, whether or not the sale is effective against the obligors is a question of perfection against the obligors. That is, if the sale is perfected against the obligors, then the sale is an effective sale against the obligors. Once the sale of receivables is perfected against the obligors, for example, the purchaser will be allowed to enforce the debts directly against the obligors and the obligors will be required to pay the purchaser rather than the seller. In order to perfect the sale of a receivable against the obligor thereof, one of the following methods needs to be used:

- (a) the seller must deliver a notice to the obligor or obtain consent from the obligor (in contrast to the perfection against third parties, there is no need for the notice/consent to bear an officially certified date (*kakutei-hizuke*)); or
- (b) where the assignment of the receivables is perfected against third parties by registration under the Perfection Exception Law, the seller or purchaser must either use the method noted above in (a) or notify the obligor of the sale of the receivables by delivering a registered certificate (*touki jikou shoumeisho*), or obtain consent from the obligor thereby.

Where the receivables contract prohibits a sale of the receivables thereunder without the consent of the obligor, the consent of the obligor will be required (the question is whether or not the contract prohibits assignments rather than whether the contract permits assignments). Otherwise, whether or not the sale is effective against the obligors is a question of perfection against the obligors.

There is no legal limitation regarding the purchaser notifying the obligor of the sale of receivables after the insolvency of the seller or the obligor; in fact, the customary contractual arrangement in securitisation transactions is that the purchaser will be allowed to notify the obligor of the sale once the seller or the obligor becomes insolvent.

Unless a sale of a receivable is perfected, the obligor will retain set-off rights and other obligor defences, therefore, perfection would be required to prevent those defences. For the avoidance of doubt, set-off rights and other defences that preceded the perfection would remain effective (with the exception of a waiver by the obligor).

**4.5 Notice Mechanics.** If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

With respect to the form of the notice, see questions 4.2 and 4.4.

As for the time limit for delivering a notice, while notice could be delivered after an insolvency proceeding has commenced against the obligor or the seller, such notice could be voided - if the notice had been delivered with the knowledge of either the fact that the obligor ceased payments or the fact that the petition for the commencement of the insolvency proceedings had been filed - by avoidance rights of insolvency trustees, unless the delivery had been made within 15 calendar days from the sale (as opposed to the commencement date of the insolvency proceedings). While a notice can be applied to future receivables, future receivables do need to be specified in a certain manner for the notice to be legal and valid (see question 4.10).

**4.6 Restrictions on Assignment - General Interpretation.** Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?

Both of the restrictions will be binding restrictions prohibiting a transfer of receivables by the seller to the purchaser absent the consent of the obligor.

**4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Japan? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Japan recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

There is no general restriction on receivables contracts prohibiting the sale or assignment of receivables, even between commercial entities. As prohibitions on the sale or assignment provided under receivables contracts are recognised, the seller will be liable to the obligor if any damage is incurred by the obligor when the seller breaches the prohibition. However, the sale of a receivable (the receivables contract in respect of which expressly prohibits assignment thereof) will not constitute a valid and effective transfer unless the purchaser, in the absence of both the knowledge of such prohibition and gross negligence in having no knowledge of the prohibition, purchased the receivables from the seller. Therefore, in cases where no transfer will be given effect, the obligor will usually incur no damages as a result of the sale.

- 4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

The sale agreement must specifically identify the receivables in order for the receivables to be validly sold. There is no minimum or specific legal requirement in identifying the receivables and it will vary depending upon the types of receivables and receivables contracts; receivables can be identified by information such as obligor names, amounts of the receivables, invoice numbers, the contract dates and/or the terms of the receivables. For so long as the receivables sold under a sales agreement are sufficiently identified, the receivables sold under the agreement do not need to share objective characteristics. Depending on the nature of the seller, it could be possible to construe that identification of receivables is sufficient if the seller sells all of its receivables; however, this will not be the case if the seller's receivables include receivables that are restricted from sale or assignment; also, if the sale includes the sale of future receivables, the sale may be deemed void. The same will apply with respect to cases where the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors. Please see question 4.9 for the assignability of future receivables.

- 4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

Any transaction could be recharacterised based on its economic characteristics regardless of the parties' designation of a transaction as a sale or any statement of such intent, on the other hand, economic characteristics of a sale will not prevent the sale from being perfected, unless the characteristics hinder the nature of the transaction and result in recharacterisation thereof. In other words, under Japanese law, provided a transaction is not recharacterised as a loan or any other transaction, economic characteristics will not prevent a sale from being perfected. On the other hand, any characteristics (which may include the seller retaining too much credit risk, interest rate risk or control over the receivables) that is inconsistent with the characteristics of sales transactions may result in recharacterisation; in this connection, retaining a right of repurchase/redemption could be viewed as generally making the transaction as being susceptible to recharacterisation.

- 4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

It is possible for the seller to agree to continuous sales of

receivables in an enforceable manner (at least prior to its insolvency), however, such continuous sales would be subject to the insolvency officials' right to rescind.

- 4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?**

Following a Supreme Court case ruling in 1999, the general belief is that it is possible for the seller to commit to sell future receivables for so long as the receivables are sufficiently specified and identified (by, for example, the obligors thereof, the transactions from which the receivables are generated, the amounts of the receivables and/or the dates on which receivables are respectively generated); provided that the sale of the receivables, in whole or in part, may be deemed or determined to be void due to a contradiction with the public welfare/interest or for any other reasons and there also is a possibility of the sale of future receivables being subject to rights of insolvency officials to rescind, especially with regard to receivables arising after the seller's insolvency.

- 4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

Provided the transfer of the receivables is enforceable and perfected against third parties, it is generally believed that a related security (other than an umbrella security interest such as an umbrella hypothec) securing the transferred receivables will also automatically be recognised as being concurrently transferred in a perfected manner (see question 4.3 above). Provided, however, with respect to certain security interests that can be registered such as a hypothec, the concurrent transfer of the hypothec will not be perfected against a third party that acquires the related security (without acquiring the obligation secured thereby) unless the concurrent transfer is separately perfected; for example, in the case of a hypothec, perfected by registration in the relevant real estate registry through a supplemental registration.

As for umbrella securities, crystallisation thereof will be required in order to provide the purchaser with the benefits of the security (although following a crystallisation, an umbrella security will no longer be an umbrella security but a regular security) or obtain the consent of the obligor or any other party who granted the security in order to transfer the umbrella security as an umbrella security to the purchaser.

- 4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

The obligor's set-off rights will terminate once it receives notice of

a sale, but only if the notice is made by the seller (not the purchaser or any other party), and the obligor is generally believed to continue to have the ability to set-off any prior claims (i.e., claims that the seller owed to the obligor prior to the notice). The obligor's set-off rights will also terminate if, and when, the obligor consents to the sale, and unless the consent is with a reservation to retain its right to set-off, the obligor will no longer have any ability to set-off (including its prior claims).

## 5 Security Issues

### 5.1 Back-up Security. Is it customary in Japan to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

Under Japanese law, the methods to perfect a sale of receivables and methods to perfect the creation of a security interest over receivables are basically the same. Therefore, it is not customary in Japan to take a "back-up" security interest. While there have been arguments about taking a "back-up" security interest in order to protect the interest of the purchaser in the event that the sale is recharacterised as a financing rather than a sale (note that the purpose is different from the term "back-up" for a failure to perfect a sale), since the creation of a "back-up" security interest would seem to contradict the parties' intention to effect a true sale and also because, even if recharacterised, transactions would likely be recharacterised as secured lending with a perfected security, it is generally assumed that the taking of a "back-up" security interest would not add much protection, but, at the same time, run the risk of working against the true sale nature of the transactions and, therefore, parties customarily do not create any "back-up" security interest.

### 5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Japan, and for such security interest to be perfected?

Seller security is not applicable in Japan.

### 5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Japan to grant and perfect a security interest in purchased receivables governed by the laws of Japan and the related security?

Under Japanese law, there is no simple way to grant a security over "all assets" of the purchaser. The purchaser must grant specific security over each specific asset class/type separately. Therefore, if receivables constitute a part of the purchaser's "all assets", then to effect and/or perfect a security interest over such receivables, the following formalities must be complied with:

For granting a security interest in receivables, a "pledge" (*shichiken*) or a "security assignment" (*jyoto-tampo*) is normally used in Japan.

#### (i) Pledge

In order to effectively pledge receivables to the creditor, the following need to be satisfied:

- while there is no formality requirement for a pledge agreement, in the agreement, the same as sales of

receivables, receivables to be pledged must be specified, and assignments thereof must not be prohibited under the relevant receivables contracts; and

- the pledgor must deliver to the pledgee the instruments evidencing such receivables, if such instruments need to be delivered in order to effect an assignment of such receivables.
- In order to perfect the creation of the pledge against third parties and obligors, one of the following methods needs to be undertaken:
- (a) the pledgor must deliver notice to the obligors, or the pledgor or pledgee must obtain consent from the obligors, which notice or consent must bear an officially certified date (*kakutei-hizuke*) by means prescribed under law in order to perfect against third parties (if no officially certified date is affixed, then the creation of the pledge will still be perfected against the obligors but not against third parties); or
  - (b) if the pledgee is a corporation, the pledgee must register the creation of the pledge in a claim assignment registration file in accordance with the Perfection Exception Law.

#### (ii) Security assignment

In order to effectively assign receivables for security purposes, the following need to be satisfied:

- while there is no formality requirement for a security assignment agreement, in the agreement, the same as with sales of receivables, receivables to be assigned for security purposes must be specified, and assignments thereof must not be prohibited under the relevant receivables contracts; and
- the same as with pledges of receivables, the assignor must deliver to the assignee the instruments evidencing such receivables, if such instruments need to be delivered in order to effect an assignment of such receivables.

In order to perfect the creation of the security assignment against third parties and obligors, one of the following measures needs to be undertaken:

- (a) the assignor must deliver notice to the obligors, or the assignor or assignee must obtain consent from the obligors, which notice or consent must bear an officially certified date (*kakutei-hizuke*) by means prescribed under law in order to perfect against third parties; or
- (b) if the assignor is a corporation, the assignor must register the assignment of receivables in a claim assignment registration file in accordance with the Perfection Exception Law.

### 5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Japan, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Japan or must additional steps be taken in Japan?

The ALGA, which is the law a Japanese court would apply in determining the applicable governing law, does not explicitly provide for rules relating to the choice of governing law in respect of security interests over receivables. However, according to the general interpretation of the statute that provided for the rules relating to the choice of governing law and which was replaced by the ALGA (which also does not explicitly provide for rules relating to the law governing security interests over receivables), the law governing a creation/granting of a pledge or a security assignment in a receivable is the law governing such receivable. The general notion is that this interpretation will remain the controlling interpretation even after the introduction of the ALGA. Therefore, if the purchaser grants a security interest in the receivables under the laws of the purchaser's country or a third country, even if the

security interest is valid under the laws of that country, Japanese courts will not treat the security interest as valid unless the subject receivables are governed by the same country's law.

As for the governing law regarding perfection of a security interest in a receivable, neither the ALGA nor the statute replaced thereby provides or provided any express rule. While the general interpretation under the replaced statute was that the perfection would be governed by the law of the obligor's domicile, it is not expected that the same interpretation will be controlling after the introduction of the ALGA. This is because, while the interpretation was reasoned upon the fact that the replaced statute expressly provided that the law of the obligor's domicile governed the perfection of an assignment of a receivable, the ALGA amended the rule and provides that the governing law of the receivable itself governs the perfection of an assignment of the receivable. Thus, it is believed that the governing law of the receivable will also govern the perfection of a security interest in the receivable. Therefore, if the purchaser perfects a security interest in the receivables under the laws of the purchaser's country or a third country, even if the security interest is determined to be perfected under the laws of that country, Japanese courts will not treat the security interest as perfected unless the subject receivables are governed by the same country's law.

## 5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

### (i) Insurance policies

There is no additional or different requirement specifically applicable only to insurance policies under Japanese law. Provided, however, that for those insurance policies that are payable to order (i.e., those that fall under the definition of *sashizu-saiken*), endorsement will be required in order to effect and perfect the transfer.

### (ii) Promissory notes

Under the Promissory Notes Law, the general method of granting security interests on promissory notes and perfection against the obligor and third parties is by the grantor endorsing the promissory notes and delivering the same to the grantee.

### (iii) Consumer loans

Unlike the sale of (consumer) loans, regulations regarding sales of loans extended by moneylenders regulated under the Moneylenders' Law (see question 8.3) do not apply to the grantee of the security interests on (consumer) loans, even if the loans are extended by a moneylender, unless, and until, the security interests are foreclosed.

### (iv) Mortgaged loans

When a security interest is validly and effectively granted over, or in, a loan that itself is secured by a hypothec (*teito-ken*) (but not in the case of an umbrella hypothec (*ne-teito-ken*)), the grantee will automatically benefit from the hypothec as the security interest will grasp the loan as a secured loan without any additional or different requirement (*zuihansei*). However, this does not mean that the grantee would be entitled to directly enforce/foreclose on the hypothec or umbrella hypothec. The security interest granted over, or in, the loan secured by the hypothec or umbrella hypothec must first be enforced/foreclosed. Thereafter, if the grantee acquires the loan secured by the hypothec or umbrella hypothec himself/herself as a result of such enforcement/foreclosure, then the grantee will be able to enforce/foreclose on the hypothec or umbrella hypothec (but only if the loan is due and payable). In order to perfect the interest, the grantee acquires as a result of the granting of the security

interest over, or in, the loan secured by the hypothec against third parties who gain interest in the hypothec after the granting of the security interest, a registration (if the security interest is a pledge, in the form of an amendment registration and if the security interest is a security assignment, in the form of a supplemental registration) needs to be made in the relevant real estate registry (however, it is generally believed that the grantee of the security interest in a mortgaged loan will prevail over a third party who acquires the mortgage loan for so long as the granting of the security interest to the grantee is first perfected (even if the registration is not made or was made after the third party's acquisition of the mortgage loan)).

In cases where the loan over which the security interest is created is secured by an umbrella hypothec, in contrast to the above, the grantee will not benefit from the umbrella hypothec as an umbrella hypothec will not be transferred unless, and until, it is crystallised into a regular hypothec.

### (v) Marketable debt securities

Similarly to question 4.3 above, we will focus on the granting of a pledge or a security assignment over or in JGBs or corporate bonds and perfection thereof. The requirements for the granting/creation of security interests in respect of these securities and perfection thereof depend on the form of the JGBs and the bonds.

#### (a) In case of JGBs

In order to pledge JGBs and to perfect such pledge, the following is required:

- (A) If in bearer form with physical certificates (*mukimei kokusai shouken*):
- the pledgor and the pledgee must agree on the creation of the pledge of JGBs and the pledgor must deliver the physical certificates to the pledgee; and
  - for continued perfection against third parties, the pledgee must continuously keep custody of the physical certificates.

#### (B) If registered JGBs (*toroku kokusai*)

An effective pledge of registered JGBs will arise if the seller and the purchaser agree to the creation of the pledge, provided that the JGBs do not prohibit the transfer thereof. For perfection against third parties as well as the government, the transfer needs to be registered in the JGB registry at the Bank of Japan in accordance with the Law Regarding Japanese Government Bonds and rules promulgated thereunder.

#### (C) If in book-entry form under the Transfer Law (*furikae kokusai*)

For the creation of a pledge over such JGBs and perfection against the government and third parties, the amount of the JGBs pledged to the pledgee needs to be entered into the pledgee's account book in accordance with the Transfer Law.

The requirements for the effective granting of a security assignment of JGBs and perfection thereof are basically the same as the requirements for the effective sale and perfection thereof as outlined in question 4.3 above.

#### (b) Corporate bonds

In order to pledge corporate bonds and to perfect such pledge, the following is required:

#### (A-1) If in bearer form with physical certificates (*mukimei shasaiken*)

Under the Corporations Act and the general Civil Code, no creation of a pledge will be effected without the physical delivery to the pledgee of the certificate in case of certificated bonds issued pursuant to the Corporations Act. For continued perfection against third parties, the pledgee must continuously keep custody of the physical certificates.

(A-2) If in non-bearer form with physical certificates (*kimeishasaiken*)

The same as (A-1) above, under the Corporations Act and the general Civil Code, no pledge will be effected without the physical delivery to the pledgee of the certificates in case of certificated bonds issued pursuant to the Corporations Act. In addition, in cases of non-bearer bonds issued pursuant to the Corporations Act, in order to perfect the transfer against third parties and against the issuer company, the pledgee's name and address must be recorded in the bond registry (*shasai genbo*) in accordance with the Corporations Act.

(B) If book-entry bonds under the Transfer Law (*furikae shasai*)

In order to pledge book-entry bonds and to perfect against the issuer company and third parties, the amount of the book-entry bonds pledged to the pledgee must be entered into the pledgee's account book in accordance with the Transfer Law.

The requirements for the effective granting of a security assignment of corporate bonds and perfection thereof are basically the same as the requirements for the effective sale and perfection thereof as outlined in question 4.3 above.

**5.6 Trusts. Does Japan recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Yes, trusts are recognised under Japanese law. In fact, a statute entitled the Trust Law governs and sets the statutory rules (some of which are mandatory rules rather than default rules).

**5.7 Bank Accounts. Does Japan recognise escrow accounts? Can security be taken over a bank account located in Japan? If so, what is the typical method? Would courts in Japan recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Japan?**

Escrow arrangements may take several forms under Japanese law as there is no legal concept of "escrow" *per se*. A trust would be one of the major legal forms that could be utilised for an escrow arrangement.

While a security interest can be created over rights of the holder of a bank account owing money to a bank in Japan, it is not a security over the bank account *per se*; rather, it is a security over a monetary claim – a claim to receive refund of the deposit – against the bank. Also, there is an argument that a security interest created over the rights of the holder of a bank account would become invalid or unperfected each time the balance of the account changes.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

No. Since, as described in question 5.7 above, a security interest over a bank account is a security over a monetary claim against the bank rather than a security over the account *per se*, the secured party will not control all cash flowing into the bank account from the enforcement forward. Technically, it may be possible – although there is, also as described in question 5.7 above, an argument that a security interest created over the rights of the holder

of a bank account would become invalid or unperfected each time the balance of the account changes – to create a security interest purporting to cover any and all cash flowing into a bank account, formal foreclosure of such security would need to be made with a specific amount of deposit.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

That may be possible, but there is an argument to the contrary (see questions 5.7 and 5.8 above for more details).

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Japanese insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

Under Japanese law, there is no system or mechanism equivalent to an automatic stay. Neither the filing of the petition for insolvency proceedings, nor the commencement of such proceedings, automatically prohibit creditors from exercising or enforcing their rights; however, Japanese insolvency courts will customarily issue stay orders as to payments on, or performance of, obligations of the insolvent. Also, upon and after the commencement of the insolvency proceedings, the creditors to the insolvent will be subjected to such proceedings and will be prohibited from exercising or enforcing their rights outside such proceedings; however, secured creditors will basically be allowed to enforce/foreclose on their security interest if the insolvency proceeding is either a bankruptcy proceeding under the Bankruptcy Code or a rehabilitation proceeding under the Civil Rehabilitation Law, in each case subject to certain rights of the insolvency official to extinguish the security interest and/or to stay the foreclosure process of the security interest.

More importantly, if the sale of the receivables prior to the commencement of the insolvency proceeding is perfected, and for so long as the sale is not recharacterised as a lending transaction rather than a true sale, the purchaser will not be a creditor to the insolvent in connection with the purchased receivables and, therefore, will have the rights and ability to collect, transfer or otherwise exercise ownership rights over the purchased receivables (note, however, that whether or not the purchaser will have the ability to terminate a servicing agreement (entered into with the seller, if any, in order to let the originator/seller service the receivables) upon the seller becoming subject to the insolvency proceeding is a separate question; if the servicing agreement cannot be terminated, the insolvent seller may remain entitled to collect the receivables, although the purchaser otherwise has the right and ability to collect the receivables).

Conversely, insolvency officials tend to challenge the true sale nature of securitisation transactions in an effort to preclude the purchaser from exercising ownership rights over the receivables

and/or challenge that the purchaser may not terminate the servicing agreement, if any, so that the insolvency officials will remain in control of the collection procedures.

---

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

---

If the sale of receivables is perfected and is a true sale, then the purchaser will not be prohibited from exercising its ownership rights over, or other rights in respect of, the purchased receivables (save for the uncertainty as to the termination of the servicing agreement).

To the contrary, if the sale is not perfected prior to the insolvency or if the sale is not a true sale, then the purchaser's exercise of rights may be prohibited or restricted. Firstly, if the sale was a true sale but not perfected, then the insolvency official would effectively rescind the sale as a result of which the receivables would claw back to the insolvent's estate. Furthermore, if the sale was not a true sale, then, irrespective of whether or not the transaction was perfected, the purchaser would be a creditor, as a result of which the purchaser's ability to exercise its rights may be restricted by the insolvency proceedings (provided, that, as described in question 6.1, if the purchaser is deemed a secured creditor with a perfected security interest, and if the insolvency proceeding was either a bankruptcy proceeding or a rehabilitation proceeding, then the purchaser as a secured creditor would be entitled to enforce/foreclose on its security interest save for limited exceptions).

---

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Japan for (a) transactions between unrelated parties, and (b) transactions between related parties?**

---

Separately from insolvency officials' right to avoid intentional acts of the insolvent that are harmful to, or that hinder, the insolvent's creditors, the Bankruptcy Code, the Civil Rehabilitation Law and the Corporate Reorganisation Law provide for avoidance rights of insolvency officials with respect to acts of the insolvent that took place after the earlier of the suspension of payments in general and the filing of a petition for the commencement of the insolvency proceedings, subject to certain conditions such as a requirement that relates to the relevant creditor's state of mind being satisfied; provided, however, that with respect to actions of the insolvent that relate to the granting of a security interest or discharging of an obligation of the insolvent, the insolvency official is entitled to avoid actions that took place after the earlier of the insolvent's inability to pay its obligations and the filing of a petition for the commencement of the insolvency proceedings, subject to certain conditions such as a requirement that relates to the relevant creditor's state of mind being satisfied (if the insolvent had no legal obligation to grant the security interest or to discharge its obligation at the time, then, the insolvency official may also avoid the relevant action provided it took place within 30 days before the insolvent's inability to pay its obligations). Furthermore, any gratuitous act (including acts that are deemed to be gratuitous) that took place

after the suspension of payments or the filing of a petition for the commencement of the insolvency proceedings or within six months before the earlier of the two can be avoided by the insolvency official.

(Please note that there are certain exceptions to the above-described rules.)

In addition to the above, creditors of the insolvent may rescind actions of the insolvent that would prejudice creditors if certain conditions required under the general Civil Code are satisfied.

---

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

---

No legal concept or theory that is equivalent or similar to the theory of substantial consolidation under US law exists under Japanese law. However, the insolvency official may be able to achieve a similar result through the application of the Japanese version of the piercing the corporate veil doctrine. That is, if the corporate veil of the purchaser is pierced, since all the assets of the purchaser would be deemed part of the seller's (or its affiliate's) assets, a similar result would be achieved. According to case law, a corporate veil will be pierced only when: (a) the legal entity is a sham; or (b) the legal entity is abused so as to avoid certain legal provisions. Note that, while there are certain factors that are to be taken into account in determining whether or not the doctrine should be applied, a recent court judgment suggested that the corporate veil of an SPC would not be pierced merely because it was a paper company.

---

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Japan, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

---

In a bankruptcy proceeding, a rehabilitation proceeding or a reorganisation proceeding, the relevant insolvency official has the ability to rescind the insolvent's obligations under a bilateral contract in respect of which both parties' obligations are yet to be fulfilled.

If an insolvency proceeding is initiated prior to the transfer of receivables resulting from the sales thereof and if the sales price has not been paid, then the insolvency official will have the ability to rescind the sales agreement. To the contrary, a sales agreement of future receivables will not be rescinded simply because the receivables are future receivables. Sales of future receivables may be rescinded if the sale was through a continuous sale in connection with which the sales price for the future receivables has not been paid.

---

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

---

Yes, that is possible if the debtor owes any obligation that will not be extinguished via limited recourse provisions.

## 7 Special Rules

### 7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Japan establishing a legal framework for securitisation transactions? If so, what are the basics?

Yes: the Law Concerning Liquidation of Assets (the “Securitisation Law”). The statute permits the setting up of a special purpose company (*tokutei mokuteki gaisha*; “TMK”) and a special purpose trust (*tokutei mokutekishintaku*; “TMS”).

While there were a number of benefits in comparison to corporations incorporated under the general corporations law used for SPCs when the Securitisation Law was first introduced, following a series of amendments to the general corporations law, many of the benefits were lost as they no longer belong only to TMKs. The primary benefits that still remain are: the pass-through tax status; beneficial tax treatment in connection especially with real estate taxes; and withholding tax on securities. Characteristically, a TMK is allowed to acquire only certain types of assets listed under the statute and the rules promulgated thereunder. In addition, TMKs are required to obtain evaluation(s) of the assets that each will acquire prior to the actual acquisitions thereof and the evaluations are required to be made by certain individuals/entities satisfying the qualifications stipulated in the statute. TMKs are allowed to issue bonds (*tokutei shasai*), physical CPs (*tokutei yakusoku tegata*) and book-entry CPs (*tokutei tanki shasai*) and preferred equity securities (*yusen shusshi*) to finance their acquisition of assets to be securitised. While a TMK may borrow money to finance such acquisition, some tax benefits would be lost if not from lenders that are qualified institutional investors defined under the Financial Instruments and Exchange Act of Japan (which is the main body of securities regulations of Japan). Since TMKs are designed to be SPCs in nature, the statute prohibits TMKs from certain matters such as hiring employees, having a branch office, not appointing an underwriter/dealer in respect of its securities, doing business other than its “securitisation business” and not delegating the management (including sale and other dispositions) of its assets to qualified third parties.

A TMS has almost never been used due to its inflexibility in connection with structuring and the absence of tax benefits in respect of withholding tax, etc.

### 7.2 Securitisation Entities. Does Japan have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Yes, see question 7.1.

(a) While there are not many special requirements in establishing a TMK other than to name it a TMK in accordance with the statute, in order for a TMK to engage in the “securitisation business”, among other requirements, the TMK must file a “business commencement statement” (*gyoumu-kaishi-todokede*) with a governmental agency prior to initiation of the TMK’s “securitisation business”; an “asset liquidation plan” (*shisan-ryuudouka-keikaku*), which identifies the assets to be securitised and the terms and conditions of asset-backed securities to be issued and/or asset-backed loans to be borrowed to finance the acquisition of such assets by the TMK, must be attached to the statement as part of the exhibits thereto.

As for the management of TMKs, the statute provides certain rules in terms of the corporate governance regime, such as the requirement that no director (*torishimariyaku*) or statutory auditor (*kansayaku*) of a TMK may be a director of the entity that sells assets to the TMK as well as the requirement that an accountant or an accountancy firm be appointed as the TMK’s statutory accounting auditor (*kaikei kansanin*) when certain conditions are met.

(b) See question 7.1 above.

(c) While there is no positive requirement/qualification for the status of a director or of a shareholder specifically stipulated under the statute, corporations in general and certain persons are barred from becoming a director (the list includes the seller or directors of the seller, bankrupt individuals receiving no rehabilitation order, individuals convicted of certain financial crimes, etc.).

### 7.3 Limited-Recourse Clause. Will a court in Japan give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

The general belief is that non-recourse provisions will be upheld as valid at least prior to the insolvency of the obligor. The same applies with most types of contracts even if a given contract is governed by non-Japanese law, so long as the provision is valid under that governing law. To the contrary, validity and legal effects of non-recourse provisions upon the insolvency of the obligor are not clear under Japanese law.

### 7.4 Non-Petition Clause. Will a court in Japan give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

The general belief is that non-petition provisions will be upheld as valid for so long as the scope of a provision is reasonable (such as the effective term of the provision being limited to one year and one day after the payment in full to the investors); however, a Japanese court may treat a petition made in violation of a non-petition as a valid petition and determine that the remedy for the violation is to be provided through monetary compensation rather than dismissing the petition.

Since the matter concerns proceedings under the Japanese legal system, the governing law of non-petition provisions should be Japanese law. Whether Japanese courts will uphold non-petition provisions governed by non-Japanese law is unclear.

### 7.5 Priority of Payments “Waterfall”. Will a court in Japan give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Yes, but excluding insolvency courts. If an insolvency proceeding is commenced in connection with the debtor, then the relevant insolvency statutes will come into effect, in which case, certain waterfall provision that contradicts the priority rules provided under the insolvency statutes will not be honoured by the competent court.

**7.6 Independent Director.** Will a court in Japan give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

The general belief is that such arrangements cannot be made under the Japanese legal environment, and therefore, in most cases, a Japanese SPC will have a sole independent director rather than having multiple directors that may include non-independent directors.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc.** Assuming that the purchaser does no other business in Japan, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Japan? Does the answer to the preceding question change if the purchaser does business with other sellers in Japan?

First, under Japanese law, there is no concept of a qualification to do business in Japan applicable to foreign corporations; however, foreign corporations are required to (1) appoint at least one representative officer/director who resides in Japan, and (2) register with a governmental agency, if they are to continuously do business in Japan; provided, further, that a foreign corporation whose primary purpose is to do business in Japan may not continuously do business in Japan, and a foreign corporation whose head office is located in Japan also may not continuously do business in Japan. Whether a one-time purchase and ownership or its collection and enforcement of receivables by a foreign SPC will be deemed a "continuous business" remains a subtle question the answer to which is unclear (but if the foreign SPC does business with other sellers, then there is a chance that it will be deemed as doing continuous business in Japan; however, the governmental authority has suggested that the regulation is not intended to be applied to foreign corporations used as vehicles in securitisation transactions). Separately, regardless of whether the purchaser is a foreign entity or a domestic entity, the purchaser may be prohibited from purchasing receivables depending on the asset class. That is, since the Lawyers' Code provides that no person may engage in the business of purchasing or otherwise acquiring receivables to enforce the receivables by means of litigation, mediation, conciliation or other means, the purchase of receivables may be deemed a violation of the Code, for example, if all of the purchased receivables are destined to be enforced through litigation. However, the Supreme Court has opined that a purchase of receivables does not violate the Code if the purchase does not harm the obligors' or public citizens' rights and legal interests and if the purchase falls within socially and economically justified business.

In addition, if the receivables to be purchased are, or include, a loan or loans extended by a moneylender regulated under the Moneylenders' Law, then certain provisions of the statute will become applicable to the purchaser (even if the purchaser is a foreign entity); see question 8.3.

**8.2 Servicing.** Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

There is no general restriction on a seller of receivables continuing to collect receivables following their sale to the purchaser, however, collection activities of the seller are legally permissible only to the extent that they do not constitute or involve "legal affairs", which include appearance before a court.

Save for limited exceptions available to judicial scriveners and the exception made available to licensed special servicers, only an attorney or a legal corporation (which is an incorporated law firm) can represent a third party and appear before a court. Therefore, unless the seller is a special servicer licensed under the Servicer Law (the Act on Special Measures concerning Business of Management and Collection of Claims), the seller will not be able to appear before a court in enforcing the receivables sold to the purchaser.

**8.3 Data Protection.** Does Japan have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Yes. The Law Concerning the Protection of Personal Information regulates the: (i) acquisition; (ii) management and use; and (iii) disclosure of personal information about individuals (*kojin-jyoho*), by certain enterprises/individuals handling such personal information (*kojin-jyoho-toriatukai-gyousha*). The statute protects information in respect of individuals but not of corporations.

In addition, certain businesses such as financial institutions and banks are required to maintain and otherwise handle information and data about, or provided by, its clients (especially individuals, but not excluding corporations or other enterprises) with the due care of professionals and maintain adequate confidentiality.

**8.4 Consumer Protection.** If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Japan? Briefly, what is required?

If the receivables are loans extended by moneylenders regulated under the Moneylenders' Law, the purchaser thereof will be subject to certain provisions of the statute, including, without limitation, the provisions providing for the following requirements:

- the purchaser will be required to deliver to each obligor, without delay, a notice that clearly indicates certain details of the relevant loan as required under the statute and rules promulgated thereunder upon the purchase of such receivables; and
- the purchaser will be required to furnish a receipt to each obligor every time the purchaser receives a payment from the obligor in accordance with the Moneylenders' Law.

**8.5 Currency Restrictions.** Does Japan have laws restricting the exchange of Japanese currency for other currencies or the making of payments in Japanese currency to persons outside the country?

(i) The Foreign Exchange and Foreign Trade Law, which is the statute primarily governing exchanges of currency does not restrict



the exchange of Japanese currency for other currencies; however, there are certain after-the-fact reporting requirements.

(ii) Under the same statute, the making of payments or other transfer of money to persons of certain countries such as countries subject to economic sanctions is subject to approval by the government. Also, if a payment or other transfer of money to persons outside of the country is made by a resident of Japan, then such resident will be required to make an after-the-fact report to the relevant authority, except for cases prescribed in the relevant rules (such as a payment of less than a hundred million Yen).

## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Japan? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

Whether withholding tax will be imposed depends on a number of factors, such as the nature of the receivables, whether they bear interest, whether the seller (or the purchaser) is a resident of Japan, whether there is a tax treaty between Japan and the country or jurisdiction of the seller (or the purchaser), and whether the payment by the obligor is made within Japan.

In the case of a sale of trade receivables at a discount, there is a high possibility that the discount will be recharacterised as interest. And, in the case of a sale of trade receivables where the payment of the purchase price is conditioned upon collection of the receivables, there is a risk/possibility that the deferred purchase price will be recharacterised as interest.

**9.2 Seller Tax Accounting. Does Japan require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

The Corporations Tax Law generally requires corporations to adopt the Japanese GAAP unless otherwise required by law. Since there is no statute that specifically provides for an accounting policy for the seller or the purchaser in the context of a securitisation transaction, the Japanese GAAP will generally control; although there are certain matters for which tax law requires modifications to the accounting principles. For securitisation of receivables, the Accounting Policy regarding Financial Products introduced by the Accounting Standards Board of Japan, as well as the Practical Policy regarding Financial Products Accounting and Q&A for the Financial Products Accounting published by a committee of the Japanese Institute of Certified Public Accountants provide the accounting rules.

**9.3 Stamp Duty, etc. Does Japan impose stamp duty or other documentary taxes on sales of receivables?**

Stamp duty (*inshi-zei*) of 200 Yen is imposed on a contract whereby a receivable is assigned (e.g., a receivables sale agreement) with a sale value equal to or greater than 10,000 Yen.

**9.4 Value Added Taxes. Does Japan impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

Consumption tax (*shohi-zei*) and local consumption tax (*chiho-shohi-zei*) are imposed on the sale of goods or services otherwise exempted by relevant laws or regulations. With respect to sales of receivables, no consumption tax is imposed, whereas consumption tax and local consumption tax will be imposed on fees for collection agent services.

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

(i) **Stamp duty**

The purchaser is liable jointly and severally with the seller, if both the purchaser and the seller have prepared the documents together.

(ii) **Consumption tax and local consumption tax**

The taxing authority cannot make claims against the purchaser or on the receivables (so long as the sale is a true and perfected sale) for the unpaid tax.

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Japan, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Japan?**

As for stamp duty, see question 9.5 (stamp duty will be imposed irrespective of the status of the purchaser). With respect to income tax, if the purchaser is a foreign corporation or a non-resident of Japan, the income from the collection of the receivables will be taxable in Japan (and, if the purchaser has no "permanent establishment" in Japan, then withholding tax would generally be imposed with respect to certain income from receivables such as interest on loans). As for corporate tax, the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors will not generally make it liable to corporate tax in Japan as long as the purchaser conducts no other business in Japan and is treated as having no permanent establishment nor its agent/representative in Japan with certain authority to act on behalf of the purchaser.

Note that if there is a tax treaty between Japan and the jurisdiction of the foreign corporation, the rules described above might be amended thereby.

**Hajime Ueno**

Nishimura & Asahi  
Ark Mori Building  
1-12-32 Akasaka, Minato-ku  
Tokyo 107-6029  
Japan

Tel: +81 3 5562 8500  
Fax: +81 3 5562 9711  
Email: [h\\_ueno@jurists.co.jp](mailto:h_ueno@jurists.co.jp)  
URL: [www.jurists.co.jp/en/](http://www.jurists.co.jp/en/)

Hajime Ueno is renowned for his expertise in the areas of structured finance, reorganisation finance and international finance. He has been involved in numerous significant securitisation transactions concerning various structures - such as true sale and synthetic structures; master trust structures, ABCP programmes - and asset classes, including residential and commercial mortgages, trade receivables, export financing, nonperforming and sub-performing loans, bonds and bank loans, including small and medium enterprise loans, as well as other assets that are not monetary claims including real properties, movable properties, whole business and intellectual properties. His extensive practice also covers other international finance areas, such as banking, trust and securities regulation, as well as BIS regulations. He is a graduate of the University of Tokyo (LL.B., 1997) and Harvard Law School (LL.M., 2004). Fluent in both Japanese and English, Mr. Ueno has co-authored a number of international and domestic journals and publications.

## NISHIMURA & ASAHI

Nishimura & Asahi is one of Japan's premier full-service law firms, covering all aspects of domestic and international business and corporate activity. The firm currently has more than 500 Japanese and foreign lawyers and employs over 500 support staff, including tax accountants, and one of the largest teams of paralegals in Japan.

Through the enhancement of professional and organisational synergies, resulting from the firm's expansion, an unprecedented level of client service is made possible in highly specialised and complex areas of commercial law. Nishimura & Asahi understands its clients' growing needs and its fully integrated team of lawyers and professional staff are proud to share the same fundamental philosophy: an uncompromising commitment to excellence.

**Offices:** Tokyo, Fukuoka, Nagoya, Osaka, Bangkok, Beijing, Hanoi, Ho Chi Minh City, Singapore, and Yangon.

**Key areas of practice:** Corporate: General Corporate; M&A; Compliance; Start-up Businesses; Labour Law; and Real Estate/Environmental. Finance: Banking; Capital Markets; Asset Management; Structured Finance/Securitisation; Asset Finance; Acquisition Finance; Insurance; and PFI/Project Finance. Restructuring/Insolvency: Restructuring/Insolvency. Cross-Border Practice: International Transactions; International Trade; International Disputes; and International Taxation. Dispute Resolution: Civil & Commercial Disputes; IP Disputes; Administrative Disputes; and Specialised Disputes. IT/IP: IP Transactions; Venture Capital/Entrepreneurial Services; and Telecommunications/Media. Corporate Crisis Management: Corporate Crisis Management. Antitrust: Antitrust. Tax: Tax Counselling; and Tax Controversy and Litigation. Trusts & Estates: Trusts & Estates. Asia: China; Hong Kong; India; Indonesia; Korea; Singapore; Taiwan; Thailand; Vietnam; and the rest of Asia. Middle East: Saudi Arabia; U.A.E.; and rest of Middle East/Islamic Transactions. Public interest activities: Assistance to Administrative Organisations; and Education and Professional Activities.

**Managing Partner:** Mr. Masaki Hosaka

**Languages:** Japanese; English; Chinese (Mandarin); and French

**Total number of lawyers:** 506

**Email:** [info@jurists.co.jp](mailto:info@jurists.co.jp)

# Luxembourg



Alex Schmitt



Andreas Heinzmann

Bonn & Schmitt

## 1 Receivables Contracts

- 1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

Under Luxembourg law (provided the parties have reached an agreement) it is not necessary that the parties enter into a written agreement to evidence the sales of goods or services. According to article 109 of the Luxembourg Commercial Code any means of evidence (including invoices) are acceptable in respect of agreements between merchants (*commerçants*) and, depending on the specific circumstances, an agreement between parties may be evidenced by their behaviour. However, according to article 1341 of the Luxembourg Civil Code, a contract, unless entered into between merchants (*commerçants*), shall be evidenced in writing if the value of the contract exceeds the amount of EUR 2,500.

- 1.2 Consumer Protections. Do Luxembourg laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

**Consumer credit.** The interest rate may, in principle, be freely determined between the parties to a loan agreement, which may exceed the legal interest. However, if the interest rate is manifestly usury, a Luxembourg court may reduce the interest to the applicable legal interest rate. 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.

**Interest on late payment.** In commercial transactions between professionals the Luxembourg law dated 18 April 2004 relating to late payment and overdue amounts, as amended, sets a maximum limit calculated on the basis of the ECB’s key interest rate (*taux directeur*) plus 8 per cent. In transactions between a professional and a consumer, a regulation sets the maximum interest rate that may be applied by such professional in the event of a delay in payment.

**Compounding of interest.** Contractual compounding of interest is, in principle, not permitted under Luxembourg law unless with

respect to interest due and payable for a period of at least one year and on which compounding the parties have agreed in writing.

**Early repayment.** A consumer has the right to early repayment of its debt without penalties. The lender may not charge any additional amount for the remaining term of the loan (i.e., interests or costs). However, the lender is entitled to recover fair and objectively justified costs which are directly linked to the early repayment provided that the early repayment has been made during a fixed-rate period.

**Consumer’s right of withdrawal.** Under article L. 224-15 of the Luxembourg Consumer Code (the **Consumer Code**), a consumer has a right of withdrawal in connection with its entry into a loan agreement with a professional without any justification and for a period of 14 calendar days calculated on the later of: (i) the day of entry into the loan agreement; or (ii) the receipt by the consumer of the terms and conditions of the loan agreement. Under article L. 221-3 of the Consumer Code, a similar right is granted to consumers in relation to a number of other agreements (i.e., distance financial services contracts).

**Moratorium on consumer’s debts.** In relation to personal debts, individuals may request assistance from the Commission of Mediation in Luxembourg. Such request triggers an automatic stay of proceedings which may have been commenced against the applicant. The stay period can last up to six months and may result, among others, in a restructuring of the debts or in a reduction of agreed interest rates.

- 1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

In general, there are no different requirements, which apply under Luxembourg law, if a receivables contract has been entered into with a public entity in Luxembourg provided the public entity is carrying out a commercial transaction and is acting *jure gestionis*, i.e., the transaction is governed by private law as opposed to sovereign acts *jure imperii*, which are governed by public law.

## 2 Choice of Law - Receivables Contracts

- 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Luxembourg that will determine the governing law of the contract?**

The provisions of Regulation (EC) n. 593/2008 on the law

applicable to contractual obligations (the **Rome I Regulation**) are directly applicable in Luxembourg. If the seller and the obligor do not specify an express choice of law governing the receivables contract, the applicable law will be the law of the country which is most closely connected to the situation and which is typically the law of the country where the party to effect the characteristic performance of the contract has its residence, except when it results from the circumstances that the contract is manifestly more closely connected with another country, in which case the law of that country shall apply.

**2.2 Base Case. If the seller and the obligor are both resident in Luxembourg, and the transactions giving rise to the receivables and the payment of the receivables take place in Luxembourg, and the seller and the obligor choose the law of Luxembourg to govern the receivables contract, is there any reason why a court in Luxembourg would not give effect to their choice of law?**

Provided both the seller and the obligor have their seat in Luxembourg, the transfer of the receivables and their payment will occur in Luxembourg and the seller and the obligor have chosen the law of Luxembourg to govern the receivables contract, the choice of the parties to have the receivable contract governed by Luxembourg law will be recognised and upheld by a Luxembourg court in accordance with the provisions of the Rome I Regulation.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Luxembourg but the obligor is not, or if the obligor is resident in Luxembourg but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Luxembourg give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

If either: (i) the seller has its seat in Luxembourg but not the obligor; or (ii) the obligor has its seat in Luxembourg but not the seller, and the parties choose the foreign law of the country in which either the obligor or the seller have their respective seat to govern the receivables contract, the choice of the parties to have the receivables contract governed by foreign law will be recognised and upheld by a Luxembourg court in accordance with the provisions of the Rome I Regulation provided the application of the provisions of foreign law would not be manifestly incompatible with Luxembourg public policy (*ordre public*).

**2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Luxembourg?**

The United Nations Convention on the International Sale of Goods was ratified by Luxembourg on 30 January 1997 and entered into force on 1 February 1998.

**3 Choice of Law - Receivables Purchase Agreement**

**3.1 Base Case. Does Luxembourg law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Luxembourg laws or foreign laws)?**

In principle, Luxembourg law does not require the sale of receivables to be governed by the same law as the law governing the receivables given that in accordance with the provisions of the Rome I Regulation, the parties are free to choose the governing law of the transfer agreement which will determine the relation between the assignor and the assignee. Pursuant to article 14 of the Rome I Regulation the law governing the receivables will, among others, determine: (i) the assignability of the receivables; (ii) the relationship between the assignee and the obligor; (iii) the conditions under which the assignment can be invoked against the obligor; and (iv) whether payment by the obligor shall have the effect of discharging the obligor's obligations.

**3.2 Example 1: If (a) the seller and the obligor are located in Luxembourg, (b) the receivable is governed by the law of Luxembourg, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Luxembourg to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Luxembourg, will a court in Luxembourg recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?**

A court in Luxembourg will recognise the sale of receivables as being effective against the seller, the obligor and other third parties (such as the creditors of the seller) provided the sale of receivables is compliant with Luxembourg law. An insolvency receiver appointed with respect to the seller would, under Luxembourg law, typically not be considered as a third party but could, under certain circumstances, refuse to be bound by the sale of receivables.

**3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Luxembourg, will a court in Luxembourg recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?**

Assuming the provisions of the Rome I Regulation are applicable, the sale of receivables is effective against the seller, the purchaser and the obligor. However, it is not clear under the Rome I Regulation, which legal provisions determine the effectiveness of a transfer of receivables against third parties other than the obligor. Luxembourg conflict of laws rules would generally point to the law of the country where the obligor is located and hence the formalities provided by the relevant foreign law for effectiveness against third parties would need to be analysed on a case-by-case basis.

If the receivables were assigned to a Luxembourg securitisation vehicle, the articles of incorporation which are governed by the

securitisation law dated 22 March 2004, as amended (the **Securitisation Law**), the law of the country where the assignor has its seat governs the condition of effectiveness of the assignment against third parties.

An insolvency receiver appointed with respect to the seller would, under Luxembourg law, typically not be considered as a third party but could, under certain circumstances, refuse to be bound by the sale of receivables.

**3.4 Example 3: If (a) the seller is located in Luxembourg but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Luxembourg recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Luxembourg's own sale requirements?**

Please see the answer to question 3.3 above.

**3.5 Example 4: If (a) the obligor is located in Luxembourg but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Luxembourg recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Luxembourg's own sale requirements?**

Please see the answer to question 3.3 above. A Luxembourg judge will designate the law of the country where the obligor has its seat. Hence, if the seat of the obligor is located in Luxembourg, the receivables purchase agreement will be binding against third parties, if the obligor has been notified of the transfer of receivables in accordance with article 1690 of the Luxembourg Civil Code.

**3.6 Example 5: If (a) the seller is located in Luxembourg (irrespective of the obligor's location), (b) the receivable is governed by the law of Luxembourg, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Luxembourg recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Luxembourg and any third party creditor or insolvency administrator of any such obligor)?**

Please see the answer to question 3.4, if the obligor has its seat in a foreign country and the answer to question 3.5, if the obligor has its seat in Luxembourg.

## 4 Asset Sales

**4.1 Sale Methods Generally. In Luxembourg what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

Under Luxembourg law, a receivable can be transferred by way of assignment, subrogation or novation.

Under Luxembourg law, receivables may be transferred by assignment, whereas the transfer of the receivable should be notified to the obligor.

Under Luxembourg law, receivables may further be transferred by way of contractual subrogation, i.e., a third party will pay to the original creditor the amount owed by the obligor and will then be subrogated to all rights the original creditor could have exercised against the obligor prior to the payment by the third party.

Further, receivables may be transferred by way of novation, i.e. all parties must consent that a new creditor will substitute the original creditor and assume its obligations under a new agreement made between the new creditor and the obligor.

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

The perfection of the sale of receivables by way of assignment requires the notification of the obligor pursuant to article 1690 of the Luxembourg Civil Code. Prior to the notification, and provided the obligor is not aware of the assignment, the obligor will be discharged while making payments to the seller.

If the sale of receivables by way of assignment occurs as transfer of title by way of security (*transfert de propriété à titre de garantie*) governed by the Law on Financial Collateral (as defined below), the assignment is perfected when the seller and purchaser have executed the transfer agreement. Hence, for perfection purposes, a notification of the transfer to the obligor is not required. However, provided the obligor is not aware of the assignment, the obligor will be discharged while making payments to the seller.

If the purchaser is a securitisation vehicle, the articles of incorporation which are governed by the Securitisation Law, and provided both the seller and the obligor have their seat in Luxembourg, the assignment of the receivables is perfected when the seller and purchaser have executed the transfer agreement. Hence, for perfection purposes a notification of the transfer to the obligor is not required. However, provided the obligor is not aware of the assignment, the obligor will be discharged while making payments to the seller.

**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

**Promissory notes and bills of exchange.** Promissory notes (*billets à ordre*) and bills of exchange (*lettre de change*) are commercial papers (*effets de commerce*) the transfers of which are regulated by the law of 15 December 1962 relating to promissory notes and bills of exchange. Pursuant to articles 11 *et seq.* of that law, promissory

notes are transferred through endorsement (*endossement*) by means of physical delivery.

**Consumer loans.** Pursuant to article L. 224-18 of the Consumer Code, the assignment of a consumer loan to a third party must be notified to the contracting consumer. However, this information is not relevant if the original creditor continues to service the credit *vis-à-vis* the consumer. Consequently, if the assignment has not been notified to the consumer, all payments made by the consumer towards the original lender are valid, as the original creditor remains the sole financial counterparty of the consumer and not the purchaser.

**Marketable debt securities.** According to the provisions of the law of 10 August 1915 on commercial companies, as amended, the transfer of debt securities in bearer form is effected by the means of physical delivery from the transferor to the transferee, whereas the transfer of the debt securities in registered form must be recorded in the relevant register and be notified to the obligor in accordance with article 1690 of the Luxembourg Civil Code.

The transfer of registered debt securities held on an account within the system of a securities depository will be carried out by matching instructions from the transferor and the transferee to the securities depository pursuant to which the securities depository will transfer the purchase price to the account of the transferor and the debt securities to the account of the transferee.

Debt securities may also be issued in dematerialised form and are transferred by book-entry transfer between the relevant securities accounts.

**Mortgage loans.** Mortgages over real estate and other assets must be formalised in a notarial deed and be registered with the mortgage register. There are no specific provisions under Luxembourg law dealing with the perfection requirements applying to the transfer of mortgages. Therefore, in accordance with the general rules applying to accessory security in Luxembourg, by transferring the receivable to the transferee, the mortgage will, by operation of law, automatically be transferred to the transferee and hence, no inscription in the mortgage register is necessary to perfect the transfer of the mortgage.

---

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

---

As set out above, the sale of receivables must, in principle, be notified by the seller or the purchaser to the obligor in order to be perfected. In any case, if the obligor is not aware of the assignment, the obligor will be discharged while making payments to the seller. The obligor's consent to the assignment is not required provided the agreement does not contain a clause preventing the seller from transferring the receivables. If the seller, despite such a clause in the agreement, assigns the receivables to the purchaser, the purchaser is, from a Luxembourg law perspective, likely not to be bound by this clause except if the purchaser has accepted the terms of the agreement.

If the purchaser of the receivables is a securitisation vehicle and the agreement between the seller and the obligor prevents an assignment of the receivables, the assignment will not be enforceable against the assigned obligor, unless (i) the obligor has agreed thereto, or (ii) the assignee legitimately ignored such non-compliance, or (iii) the assignment relates to a monetary claim (*créance de somme d'argent*).

Provided the conditions for a set-off are satisfied at the time of the perfection of the assignment, the obligor may set off its debt against obligations owed by the seller to the obligor even after a notification of the assignment.

---

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

---

There are no particular rules applying to the form of notice and the manner in which the notice is delivered to the obligor. The notice can extend to future receivables provided the future receivables are determined or determinable.

In principle, the notice can be delivered to the obligor after the sale of the receivables and after insolvency proceedings have been commenced against the seller. However, the notification of the sale to the obligor after insolvency proceedings have been commenced against the seller would not be binding against third parties including the insolvency receiver appointed in respect of the seller.

---

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that "None of the seller's rights or obligations under this Agreement may be transferred or assigned without the consent of the obligor" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the seller without the consent of the obligor" (i.e., the restriction does not refer to rights or obligations)?**

---

The assessment of the above depends on the governing law, the specific content and the purpose of the agreement made between the seller and the obligor and must therefore be analysed on a case-by-case basis. Among others, it needs to be analysed whether the purchaser of the receivables will replace the seller in the contractual relationship with the obligor as a consequence of the assignment.

Depending on the type of contract and the main contractual obligations agreed between the parties, a restriction on assignment as regards the agreement as a whole could, from a purely Luxembourg law perspective, not necessarily be construed as requiring the consent of the obligor with respect to the transfer of receivables by the seller to the purchaser provided the receivables could qualify as specific rights and obligations, which are separate from the agreement as a whole.

Conversely, a restriction on assignment as regards the rights and obligations under the agreement would, from a purely Luxembourg law perspective, generally be construed as prohibiting a transfer of receivables from the seller to the purchaser given that the rights and

obligations deriving from the receivables qualify as rights and obligations under the agreement.

**4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Luxembourg? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Luxembourg recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

As regards the enforceability of clauses in an agreement restricting the assignment of receivables please see the answer to question 4.4 above. Provided the obligor has suffered damages, the seller and the purchaser (if the purchaser is not acting in good faith) could, in principle, be held liable for breach of contract or tort.

**4.8 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells *all* of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The transfer agreement does not need to specifically identify each of the receivables. However, the assigned receivables must be determined or determinable.

**4.9 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

In principle, a Luxembourg court will consider the economic characteristics of the sale and not *per se* rely on the denomination of the transaction given by the parties.

Unless a Luxembourg court, based on the factual elements of a transaction, takes the view that it was the intention of the parties to transfer the receivables for security purposes rather than to achieve a true sale and, despite the seller, retaining the credit risk, the interest risk, the control of collections of receivables or a repurchase/redemption right in relation to the receivables, it is unlikely that a Luxembourg court would, provided the sale of receivables has been duly perfected, recharacterise the transaction as a secured loan, even though this has not yet been tested in court.

Pursuant to the provisions of the Securitisation Law, a claim assigned to a securitisation vehicle becomes part of its property as from the date on which the assignment becomes effective notwithstanding any undertaking of the securitisation vehicle to

reassign the claim at a later date and that the assignment can be recharacterised on grounds relating to the existence of such undertaking. Furthermore, the securitisation vehicle may entrust the assignor or a third party with the collection of receivables or with any other task relating to their management.

**4.10 Continuous Sales of Receivables.** Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

The seller may agree to a continuous sale of receivables provided the receivables are determined or determinable and that the sale has been notified to the obligors.

**4.11 Future Receivables.** Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?

In principle, a sale of future receivables is possible under Luxembourg law provided the future receivables are determined or determinable and that the sale has been notified to the obligor(s).

The Securitisation Law expressly allows the assignment of future receivables and a securitisation vehicle can assert the assignment against third parties from the time of the agreement with the seller on the effective assignment of future receivables, which applies notwithstanding the opening of insolvency proceedings against the seller prior to the date on which the receivables come into existence.

**4.12 Related Security.** Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

The assignment of the receivables triggers, from a Luxembourg law perspective, the transfer of all rights and obligations incidental to the assigned receivables in favour of the purchaser. Thus, all accessory security interests (provided they are governed by Luxembourg law) securing the obligations under the assigned receivables are transferred, by operation of the law, to the purchaser and are enforceable by the purchaser against third parties. No further formalities are requested under Luxembourg law in this respect.

**4.13 Set-Off; Liability to Obligor.** Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?

Legal set-off arises automatically and by operation of law where there are reciprocal claims between the parties, which are certain, due and payable. Provided the receivables contract does not

contain a waiver as regards the set-off rights of the obligor against the seller, the notification of the transfer of receivables by the seller to the obligor does not trigger the termination of the obligor's set-off rights. As a result, provided the conditions for a set-off are satisfied at the time of the perfection of the assignment, the obligor may set off its debt against obligations owed by the seller to the obligor even after a notification of the assignment.

Provided that: (i) the conditions for a set-off were not satisfied at the time of the perfection of the assignment (i.e. the scenario set out in the previous paragraph does not occur and the notification of the transfer of receivables by the seller terminates the obligor's set-off rights); (ii) the receivables contract does not contain a waiver as regards the set-off rights of the obligor against the seller; and (iii) the seller has suffered damages, the seller and the purchaser (if the purchaser is not acting in good faith) could, in principle, be held liable for breach of contract or tort.

## 5 Security Issues

### 5.1 Back-up Security. Is it customary in Luxembourg to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

Given that, in general, it can be ascertained that the sale of receivables has been perfected, it is not customary in Luxembourg to take security over the seller's ownership interest in the receivables. However, the taking of additional security is, of course, possible.

### 5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Luxembourg, and for such security interest to be perfected?

Please see the answers to questions 5.1 and 5.3.

### 5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Luxembourg to grant and perfect a security interest in purchased receivables governed by the laws of Luxembourg and the related security?

The Law of 5 August 2005 on financial collateral arrangements, as amended (**Law on Financial Collateral**) typically governs agreements creating security interests over receivables.

In practice, security interests over receivables are either created by a pledge agreement or by a transfer of title by way of security agreement each governed by the provisions of the Law on Financial Collateral.

To perfect a pledge over receivables the purchaser acting as pledgor must be dispossessed with respect of the pledged assets, which can typically be achieved by notifying the obligor of or, as the case may be, having the obligor accept, the pledge over receivables.

With respect to a transfer of title by way of security the purchaser transfers the ownership in relation to the receivables to the secured parties until the secured obligations have been discharged triggering the obligation of the secured parties to retransfer the receivables to the purchaser. When executed by the purchaser and the secured parties, the transfer agreement has been perfected. However, the obligor of the receivables will be discharged while making

payments to the purchaser unless the obligor has been notified of the transfer of the title of the receivables to the secured parties.

A securitisation vehicle may only create security interests over its assets for the purpose to secure the obligations it has assumed for their securitisation or in favour of its investors or the trustee or fiduciary-representative acting for the investors.

### 5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Luxembourg, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Luxembourg or must additional steps be taken in Luxembourg?

The creation, perfection and enforcement of a security interest over receivables, which are, or are deemed to be, located in Luxembourg, are, pursuant to applicable Luxembourg conflict of laws rules, governed by Luxembourg law.

Hence, even if the security interest over Luxembourg receivables were to be validly created and perfected pursuant to the applicable law of the country, where the purchaser has its seat, said security interest would, from a Luxembourg conflict of laws perspective, only be validly created, perfected and enforceable, if the applicable Luxembourg rules are complied with.

### 5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Security interests over claims arising under insurance policies, mortgage loans or consumer loans would either be granted in the form of a pledge or a transfer of title by way of security and insofar, as regards their perfection, the answer to question 5.3 is applicable.

A security interest over a promissory note is perfected by way of endorsement indicating that the security has been transferred for security purposes.

A security interest over debt securities in bearer form is perfected by the physical delivery of the debt securities to the pledgee or, as the case may be, depositary acting for the pledgee. A security interest over debt securities in registered form is perfected by inscription of the pledge in the register held with the issuer of the debt securities. A security interest over debt securities held in an account within the system of a securities depositary is perfected by, among others, (i) the entry into the pledge agreement made between the pledgor, the pledgee and the securities depositary or between the pledgor and the pledgee with notification to the securities depositary provided the latter will follow the pledgee's instructions relating to the debt securities, (ii) the registration of the debt securities in an account opened in the name of the pledgee, or (iii) the indication in the books of the securities depositary that the debt securities are pledged provided the debt securities are held in an account opened in the name of the pledgor.

A transfer of title by way of security in relation to registered debt securities is perfected by the transfer of the debt securities to an account opened in the name of the transferee or, if the debt securities are held in an account opened in the name of the transferor, the indication in the books of the account bank, that legal title to the debt securities has been transferred to the transferee.



**5.6 Trusts. Does Luxembourg recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Pursuant to the law of 27 July 2003 on trusts and fiduciary agreements (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.

Furthermore, according to the Fiduciary Law, a Luxembourg fiduciary may enter into a fiduciary agreement with a fiduciant, 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 are held off-balance.

**5.7 Bank Accounts. Does Luxembourg recognise escrow accounts? Can security be taken over a bank account located in Luxembourg? If so, what is the typical method? Would courts in Luxembourg recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Luxembourg?**

Luxembourg law recognises the mechanism of escrow accounts, though this mechanism does not constitute a security *stricto sensu* and is not covered by the Law on Financial Collateral.

Security interests may be created over the balance standing to the credit of a specific bank account, which typically take the form of a pledge governed by the Law on Financial Collateral.

If, pursuant to Luxembourg conflict of laws rules, an account is located, or would be deemed to be located, in Luxembourg, the relevant Luxembourg provisions will apply regarding the creation, perfection and enforceability of a security interest over such account. Hence, if the foreign law would not provide for the same rules, a Luxembourg court will not recognise the foreign law security interest over a Luxembourg account and would apply the relevant Luxembourg rules as regards the creation, perfection and enforceability of a security interest over an account located in Luxembourg.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

Upon the occurrence of an event of default, the secured party would enforce the account pledge. As a result, the account bank would block the pledged account and the pledgor would have no further access to the account. Hence, the pledgee controls, upon the occurrence of an event of default, the pledged account (unless the parties have agreed on a different mechanism in the pledge agreement regarding the access to the account after an event of default has occurred) until the secured obligations have been fully discharged. Following the discharge of the secured obligations, the pledgee has the obligation to de-block the account and to release the pledge.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Pursuant to the provisions of the Law on Financial Collateral, the

pledgee may grant to the pledgor a right of use with respect to the financial instruments and of the cash receivables pledged in favour of the pledgee.

Typically, the parties agree on the obligation of the person, to whom the right of use has been granted, to transfer an equivalent collateral to replace the financial instruments and cash receivables at the latest on the date scheduled for the performance of the obligations under the pledge agreement or at any prior date upon the occurrence of margin calls, if the value of the pledged assets has decreased to a certain collateralisation percentage in respect of the amount of the secured obligations owed to the pledgee.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Luxembourg insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

Provided the sale of the receivables cannot be challenged by the insolvency receiver appointed with respect to the seller, i.e. (i) the sale of receivables has been perfected in connection with applicable law, (ii) the sale has not been executed during the pre-bankruptcy suspect period, which is a period of six months and ten days preceding the opening of insolvency proceedings against the seller, or (iii) the receivables were not transferred under value, there will be no stay of action preventing the purchaser from collecting, transferring or otherwise exercising ownership rights with respect to the receivables.

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

The insolvency receiver could prohibit the purchaser's exercise of rights by way of summary proceedings while challenging the validity of the transfer or the perfection of the transfer of the receivables.

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Luxembourg for (a) transactions between unrelated parties, and (b) transactions between related parties?**

As stated in the answer to question 6.1 above, the insolvency receiver could challenge the validity of the transfer of receivables, if the transfer were executed during the pre-bankruptcy suspect period, which is a period of six months and ten days preceding the opening of insolvency proceedings against the seller.

As regards the length of the pre-bankruptcy suspect period, there is no difference with respect to transactions carried out between

related or unrelated parties. However, if the activities and assets of the seller and the purchaser are commingled and hence could be seen as one common estate, the insolvency receiver may, depending on the factual circumstances, extend insolvency proceedings to the purchaser, which were initially commenced against the seller.

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

In principle, and subject to what is stated in the answer to question 6.3 above, the insolvency receiver could not, in the context of an insolvency scenario, consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates.

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Luxembourg, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

Provided the provisions of the Securitisation Law are applicable, a securitisation vehicle can assert the assignment of future receivables against third parties from the time of the agreement with the seller on the effective assignment of future receivables, which applies notwithstanding the opening of insolvency proceedings against the seller prior to the date on which the receivables come into existence.

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

Under Luxembourg law there is only little published case law and legal literature as regards limited recourse provisions. As a consequence, Luxembourg law would tend to turn to Belgian legal doctrine and case law, which we understand admit, in principle, the validity and enforceability of limited recourse provisions provided the *pari passu* treatment of creditors is not violated and the limited recourse provisions are not designed to unfairly impair the rights of certain creditors to the detriment of one or more creditors.

Provided that the contractual limited recourse provisions in the documentation, to which the debtor and the creditor are a party, are effective and lawful under Luxembourg law (when the debtor is a securitisation undertaking under the Securitisation Law or a fiduciary within the meaning of the Fiduciary Law), the creditor should, from a Luxembourg law perspective, not have an interest to act (*intérêt à agir*) against the securitisation undertaking or the fiduciary beyond the available pool of assets to which its recourse is limited and, depending on the contractual mechanism embedded in the documentation, its claim should be extinguished once the relevant assets have been realised. As a result, the creditor should not be in a position to file a valid petition for bankruptcy against the securitisation undertaking or the fiduciary with the competent Luxembourg court on the basis of the balance of the outstanding debt, where the assets of the securitisation undertaking or the fiduciary prove to be insufficient to fully satisfy the claim of the creditor.

## 7 Special Rules

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Luxembourg establishing a legal framework for securitisation transactions? If so, what are the basics?**

The Securitisation Law established a particular legal framework for securitisation transactions in Luxembourg.

In accordance with the Securitisation Law, a securitisation is a transaction by which a securitisation vehicle acquires or assumes, directly or through another vehicle, risks relating to claims, other assets, or obligations assumed by third parties and issues securities, whose value or yield depends on such risks.

Under the Securitisation Law, almost all classes of assets are capable of being securitised.

The securitisation may be completed either (i) on a true sale basis, whereas the securitisation vehicle will acquire full legal title in relation to the underlying assets, or (ii) by the synthetic transfer of the risk pertaining to the underlying assets through the use of derivative instruments. To finance the transfer of risk, the securitisation vehicle must issue negotiable securities, i.e. equity or debt instruments, which can be freely transferred by assignment or physical delivery and which are subscribed by the investors. With the issue proceeds derived from the securities' issue, the securitisation vehicle will acquire the risks pertaining to the underlying assets.

**7.2 Securitisation Entities. Does Luxembourg have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

The Securitisation Law allows for two types of securitisation entities, which may be set up in the form of a company or a fund.

A securitisation fund does not have legal personality, is managed by a management company and consists of one or more co-ownerships (*copropriétés*) or one or more fiduciary estates. The management regulations expressly specify whether the fund is subject to the provisions of the Luxembourg Civil Code on co-ownership or to the rules on trusts and fiduciary contracts set out in the Fiduciary Law and which allows for the legal separation of the fiduciary assets from the trustee's assets.

It should be noted, that, in practice, securitisation funds are not often used and, in most cases, the securitisation vehicle is incorporated in accordance with the general provisions of the Luxembourg law dated 10 August 1915 on commercial companies, as amended, whereas the articles of incorporation of the securitisation vehicle are expressly made subject to the provisions of the Securitisation Law.

A securitisation company can be set up as a public limited liability company (*société anonyme*), a corporate partnership limited by shares (*société en commandite par actions*), a private limited liability company (*société à responsabilité limitée*) or a co-operative company organised as a public limited company (*société coopérative organisée comme une société anonyme*).

Unless the securitisation transaction is carried out as a private placement, a securitisation company will be incorporated as a public limited liability company given that a private limited liability company may not issue securities to the public.

Further, if a securitisation vehicle will issue securities to the public on a continuous basis, its activity must be authorised by the Luxembourg financial sector regulator (the CSSF) prior to the first issue of securities. However, the securitisation vehicle may be exempt from the requirement to be licensed by the CSSF provided it does not issue more than three series of securities per year to the public or the denomination of the securities is at least EUR 125,000. If a securitisation vehicle is a regulated entity, the CSSF must approve the directors of the vehicle and hence the directors will need to evidence a certain track record and experience within the field of securitisation.

**7.3 Limited-Recourse Clause. Will a court in Luxembourg give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

Under the Securitisation Law, contractual limited recourse clauses are recognised (even if the relevant agreement or the terms and conditions of the notes are not governed by Luxembourg law) and will be upheld by Luxembourg courts. In addition, the Securitisation Law provides for a statutory ringfencing mechanism, which can be established by the creation of compartments within the securitisation vehicle. The securitisation vehicle may allocate assets and liabilities to a specific compartment and the creditors and investors of that specific compartment have no recourse to assets, which are allocated to other compartments of the securitisation vehicle, i.e. each compartment forms a separate estate the assets of which are segregated from those allocated to other compartments of the securitisation vehicle. The constitutional documents of the securitisation vehicle and the transactions documents entered into in relation to a specific securitisation transaction should always contain the appropriate limited recourse wording.

**7.4 Non-Petition Clause. Will a court in Luxembourg give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

Under the Securitisation Law non-petition clauses are recognised (even if the relevant agreement or the terms and conditions of the notes are not governed by Luxembourg law) and will be upheld by Luxembourg courts. Hence, investors or creditors of the securitisation vehicle may waive their right to submit a petition for the commencement of insolvency proceedings against the securitisation vehicle.

The constitutional documents of the securitisation vehicle and the transactions documents entered into in relation to a specific securitisation transaction should always contain the appropriate non-petition wording.

**7.5 Priority of Payments "Waterfall". Will a court in Luxembourg give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

Under the Securitisation Law subordination clauses are recognised

(even if the relevant agreement or the terms and conditions of the notes are not governed by Luxembourg law) and will be upheld by Luxembourg courts. The constitutional documents of the securitisation vehicle and the transactions documents entered into in relation to a specific securitisation transaction should always contain the appropriate subordination wording.

**7.6 Independent Director. Will a court in Luxembourg give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

The enforceability of contractual provisions prohibiting the directors from taking specified actions (including commencing insolvency proceedings) without the affirmative vote of an independent director could be problematic from a Luxembourg perspective given that, in certain circumstances, the directors may have the legal obligation to make a filing for insolvency. However, the relevant articles of incorporation could provide that certain actions can only be validly taken with the affirmative vote of the independent director. However, the relevance of such a clause may be less important in the Luxembourg context, since a Luxembourg securitisation vehicle should be insolvency-remote.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Luxembourg, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Luxembourg? Does the answer to the preceding question change if the purchaser does business with other sellers in Luxembourg?**

The purchaser will not be required to obtain a business licence in Luxembourg or an authorisation from the CSSF approving its activity in connection with the provisions of the Luxembourg law dated 5 April 1993 on the financial sector, as amended, (the **Financial Sector Law**) only because the purchaser will purchase or collect receivables from one or more sellers having their seat in Luxembourg or enforce, as the case may be, the receivables in Luxembourg acquired from them.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

A debt collection activity carried out in Luxembourg requires, in principle, the prior authorisation of the CSSF pursuant to the relevant provisions of the Financial Sector Law. However, a securitisation vehicle may entrust the seller or a third party with the collection of receivables. In such a scenario, the seller or the third party, acting as a servicer, do not need to apply for a CSSF licence under the Financial Sector Law.

In a true sale transaction, the purchaser or, as the case may be, its representative will appear in court with respect to any litigation in

connection with the receivables given that the purchaser is the legal owner of the receivables.

---

**8.3 Data Protection. Does Luxembourg have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

---

The Law of 2 August 2002 on the protection of persons with regard to the processing of personal data, as amended, (the **Data Protection Law**) establishes standards for the collection and processing of personal data, which restrict, among others, the use and dissemination of data about, or provided by, obligors to third parties and to entities having their seat in non-EU Member States. The person, whose data will be processed, has a right of information, a right to access the data, and a right to oppose any processing or communication of that data. The Data Protection Law only covers the processing of personal data in relation to individuals.

---

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Luxembourg? Briefly, what is required?**

---

The Consumer Code provides rules that are binding on the purchaser of receivables arising under a consumer credit contract. In general, notification with respect to the transfer of the receivables to the obligor should be made by the seller (article L. 224-18 (2) of the Consumer Code). However, a notification is not required if the seller continues to service the credit *vis-à-vis* the consumer. Further, pursuant to Article L. 224-18 (1) of the Consumer Code the consumer retains the right to raise all defences and exceptions against the purchaser, which the consumer could have raised against the seller prior to the perfection of the transfer of the receivables.

---

**8.5 Currency Restrictions. Does Luxembourg have laws restricting the exchange of Luxembourg's currency for other currencies or the making of payments in Luxembourg's currency to persons outside the country?**

---

Luxembourg does not have currency or exchange controls or central bank approval requirements restricting payments to entities located outside Luxembourg.

## 9 Taxation

---

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Luxembourg? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

---

As a matter of principle, there is no withholding tax in Luxembourg on payments of all items of income from capital other than dividends. In particular, Luxembourg does not apply any withholding tax on interest paid by one of its residents to a Luxembourg non-resident. The

withholding tax exemption also covers dividend payments made by securitisation companies or funds on shares.

By way of exception, payments on receivables could be subject to the Luxembourg so-called "Relibi Law" and European Savings Directive (the **EUSD**), which establish respectively a final 10 per cent and a 35 per cent withholding tax on interest or other similar income (including interest accrued, if any, on Zero Coupon Bonds, be it as part of the sale proceeds on the sale of Zero Coupon Bonds before maturity or before payment or as a premium at redemption or payment of Zero Coupon Bonds) paid by a paying agent established in Luxembourg to a natural person resident respectively in Luxembourg and in another EU Member State. The individual may relieve himself or herself from the EUSD's withholding tax if he or she agrees to an exchange of information between the Luxembourg tax authorities and the tax authorities of the relevant Member State.

Unless the terms of a sale of trade receivables could be considered abusive, there is no reason to recharacterise a discount or a deferred purchase price as interest. However, it should be borne in mind that a repayment above the discounted price would be fully taxable unless such sale at a discount would be structured in a tax efficient way.

---

**9.2 Seller Tax Accounting. Does Luxembourg require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

---

Luxembourg has no specific accounting policy for tax purposes in the context of securitisation insofar as the Luxembourg tax law usually follows the accounting rules applicable in Luxembourg as per the law of 10 August 1915 on commercial companies, as amended.

The Luxembourg accounting rules will vary according to the legal form adopted by the seller or purchaser.

With regard to securitisation vehicles, the form may either be that of a securitisation company or that of a securitisation fund. In both cases, an independent auditor must audit the securitisation vehicle. If the securitisation vehicle opts in or issues securities to the public on a continuous basis, both the securitisation vehicle and the independent auditor must be authorised by the CSSF.

A securitisation company is subject to the accounting rules under the law of 19 December 2002, whereas a securitisation fund is subject to accounting and tax regulations applicable to investment funds provided for by the law of 17 December 2010. Thus, the securitisation company may choose between Luxembourg GAAP under the historical cost convention, Luxembourg GAAP under the fair value convention, or IFRS, while the securitisation fund may choose IFRS or Luxembourg GAAP under mark-to-market convention unless otherwise stated in the management regulations.

Crucially, the CSSF has confirmed that securitisation companies with multiple compartments should present their financial statements in such a form that the financial data for each compartment is clearly stated.

In addition, waterfall structures and valuation methods used to identify impairments or losses related thereto should be presented in the notes to the financial statements.

Finally, a securitisation vehicle may book additional liability (at least tax-wise) to compensate "technical profit", i.e., profit linked to cash flows received by the securitisation vehicle which will be distributed to the shareholders of the securitisation company or the unit holders of the securitisation fund in later financial years, in order to provide a true and fair view of the financial situation and to avoid unwarranted taxation.

### 9.3 Stamp Duty, etc. Does Luxembourg impose stamp duty or other documentary taxes on sales of receivables?

According to article 52 § 1 of the amended law of 22 March 2004, all agreements entered into in the context of a securitisation transaction as well as all other deeds relating to such transaction are exempt from registration formalities if they do not have the effect of transferring rights pertaining to Luxembourg real estate, aircraft or ships. However, they may be presented for registration, in which case they will be subject to a fixed charge of EUR 12.

### 9.4 Value Added Taxes. Does Luxembourg impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

A securitisation vehicle should be considered as a taxable person according to Circular n. 723 issued by the Luxembourg VAT Administration (*Administration de l'enregistrement et des domaines*). Should the purchaser be considered as a taxable person in Luxembourg, the sale of goods or services would generally be subject to VAT at rates typically lower than those of Luxembourg's neighbours (12 per cent and 15 per cent). However, transactions (except those related to collection of receivables) and negotiations related to receivables as well as management of securitisation vehicles located in Luxembourg are exempt from VAT.

The concept of "management" of securitisation vehicles is quite vague. In addition to the management of the portfolio (by the securitisation company itself, a management company or fiduciary representative), most administrative services (e.g., collection services) should benefit from the VAT exemption.

### 9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

The purchaser is jointly and severally liable for the payment of VAT on goods and services sold to it (including relevant fines) toward the State where the VAT is due except if the purchaser proves that it has, in good faith, paid the VAT to the supplier.

### 9.6 Doing Business. Assuming that the purchaser conducts no other business in Luxembourg, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Luxembourg?

Regarding tax that the purchaser would be responsible to withhold, the rules detailed above in question 9.1 are applicable. As the investors are treated like bondholders with no direct profit participation, no withholding tax should be applicable unless the payments of the purchaser fall under the scope of the "Relibi Law" or of the EUSD (it should nevertheless be kept in mind that the Luxembourg securitisation vehicles are entirely free to choose the kind of securities they issue and, therefore, may opt out of the Relibi Law and EUSD).

Regarding net wealth tax, securitisation vehicles are exempt.

Regarding corporate income tax and municipal business tax, the tax treatment depends on the form of the purchaser.

#### A. Securitisation vehicle organised as a corporate entity

A securitisation vehicle organised as a corporate entity with either its statutory seat or central administration in Luxembourg is fully liable to corporate income and municipal business taxes at an aggregate tax rate of 29.22 per cent (irrespective of the vehicle's activity and possible appointment of a servicer or collection agent). However, in this case, commitments made by the purchaser to remunerate its investors qualify as interest on debt (even if paid as return on equity) and are fully tax deductible. Hence, the purchaser's taxable basis should, as a rule, be very limited if not nil.

The purchaser should, nevertheless, be subject to a minimum flat tax. As of 1 January 2013, the purchaser should be identified as a *Soparfi* (i.e., a corporation that has aggregate financial assets, securities and bank deposits exceeding 90 per cent of its balance sheet total) and therefore be subject to a EUR 3,210 minimum flat tax (which includes a 7 per cent solidarity surcharge).

Moreover, no capital duty applies on incorporation of the corporate form (except for a fixed registration duty of EUR 75).

Ultimately, securitisation companies may obtain tax residency certificates from the Luxembourg tax authorities to fully benefit from the European directives and Luxembourg's important tax treaty network.

#### B. Securitisation funds

Securitisation funds should arguably be considered tax-wise as investment funds transparent for Luxembourg tax purposes. Hence, they are not liable to corporate income tax and municipal business tax.

Finally, both the fiduciary representative and the management company of a securitisation fund with their statutory seat or central administration (or even permanent establishment) in Luxembourg should be subject to corporate income tax, municipal business tax and net wealth tax in Luxembourg. They may also be subject to VAT (please refer to question 9.4 *supra*). The fiduciary representative must, in addition, pay a registration tax of EUR 1,000 and an annual registration tax of EUR 1,000 to the CSSF.

**Alex Schmitt**

Bonn & Schmitt  
22-24, Rives de Clausen  
L-2165  
Luxembourg

*Tel:* +352 27 855  
*Fax:* +352 27 855 855  
*Email:* [aschmitt@bonnschmitt.net](mailto:aschmitt@bonnschmitt.net)  
*URL:* [www.bonnschmitt.net](http://www.bonnschmitt.net)

Alex Schmitt is the senior partner of Bonn & Schmitt and has been practising in banking and capital markets law for over twenty years. He is continuously ranked as a leading Luxembourg lawyer in numerous surveys. He regularly publishes in this field of expertise. He teaches at the University of Luxembourg, including lectures on Financial Collateral.

**Andreas Heinzmann**

Bonn & Schmitt  
22-24, Rives de Clausen  
L-2165  
Luxembourg

*Tel:* +352 27 855  
*Fax:* +352 27 855 855  
*Email:* [aheinzmann@bonnschmitt.net](mailto:aheinzmann@bonnschmitt.net)  
*URL:* [www.bonnschmitt.net](http://www.bonnschmitt.net)

Andreas Heinzmann is a partner in the banking and capital markets group of Bonn & Schmitt and specialises in securities law and capital markets regulation. He advises clients 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 this field of expertise.

**BONN & SCHMITT**  
— AVOCATS —

Bonn & Schmitt is a leading Luxembourg law firm with an extensive international practice. The firm's attorneys are experienced practitioners in the Luxembourg legal environment and represent a broad spectrum of expertise that allows them to deliver unrivalled legal solutions in one of Europe's leading financial centres.

# Netherlands



Mariëtte van 't Westeinde



Jan Bart Schober

Loyens &amp; Loeff N.V.

## 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

- (a) No, it is not required under Dutch law that the debt obligation of the obligor to the seller be documented in, or evidenced by, a formal receivable contract in order for this debt obligation to be enforceable. If the existence of the debt receivable can be substantiated in any other way than by means of a formal receivable contract, such receivable can equally be enforced.
- (b) An invoice can serve as such alternative, written proof of the existence of the receivable, subject to proof to the contrary by the obligor.
- (c) In view of the fact that a creditor-obligor relationship can be assumed to exist even in the absence of a formal receivable contract, a receivable “contract” can be deemed to exist as a result of the behaviour of the parties.

**1.2 Consumer Protections. Do the Netherlands’ laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

- (a) The Decree on Credit Compensation (*Besluit kredietvergoeding*) contains provisions limiting the maximum interest to be charged by the lender. This Decree regulates the offering of the most common types of consumer credit (excluding, *inter alia*, mortgage loans) by companies and/or persons acting in the course of their profession or business to private individuals (*consumers*). As to credits and other receivables not covered by the Decree on Credit Compensation, parties are, in principle, free to fix the rate of interest or, as the case may be, default interest. Although usury rules as such do not exist in the Netherlands, exorbitant interest rates may be held to contravene morality (*bonos mores*) or public order. Consequently, contract clauses that provide for such interest rates may be void or voidable. It might also be contrary to the principles of reasonableness and fairness to attempt to enforce usurious interest rate clauses or floating interest clauses which do not provide sufficient clarity on which basis the floating interest can be

revised. Compounding of interest is permissible in the Netherlands.

- (b) Pursuant to section 6:119, or as the case may be, section 6:119a of the Dutch Civil Code (*Burgerlijk Wetboek*), damages due because of a delay in the payment of a sum of money consist of the statutory interest on that sum over the period during which the obligor is in default. Section 6:119a of the Dutch Civil Code applies to agreements between companies and/or persons acting in the course of their profession or business and which relate to the supply of goods or the provision of services. At the end of each year, the sum for which the statutory interest is calculated is increased by the interest due over that year. The statutory interest is fixed by governmental decree. The amount of the damages actually suffered is irrelevant. The creditor is entitled to the statutory interest, unless the parties have agreed to an interest rate higher than the statutory rate.
- (c) Consumers may cancel a distance contract (*overeenkomst op afstand*, e.g., a contract concluded over the internet or by telephone) without owing a fine and without giving reasons, during a period of seven business days commencing on the day when that contract was concluded or goods were received, or during a period of seven business days commencing on the day when the consumer received the information that the company was required to supply. It is expected that this term will be extended by up to 14 calendar days in mid-June 2014 in accordance with European Directive 2011/83/EU. Consumers may generally cancel their credit contract (excluding, *inter alia*, mortgage loans), without owing a fine and without giving reasons, during a period of 14 calendar days commencing on the day when that contract was concluded, or during a period of 14 calendar days commencing on the day when the consumer received the information that the company was required to supply, irrespective of whether it is a distance contract (*overeenkomst op afstand*) or not. Besides, if a consumer has a credit contract for an indefinite period of time, the consumer may terminate the credit agreement free of charge and repay the outstanding amount thereunder at any time. If a notice period has been included, this notice period may not be longer than one month.
- (d) Besides the provisions that limit the maximum interest to be charged by a lender in respect of consumer credits, there are several provisions protecting consumers. For example, pursuant to section 33 of the Dutch Consumer Credit Act (*Wet op het consumentenkrediet*) which regulates the providing of credit by companies and/or persons acting in the course of their profession or business to private individuals (*consumers*), a consumer credit contract is, *inter alia*, null and void if (i) the borrower has an obligation to enter into another agreement except if such borrower is free to choose its counterparty to such agreement, or (ii) the borrower has an obligation to assign

or pledge to the lender its income, social security benefits or other similar payments as security for its payments under the relevant consumer credit contract. Provisions protecting the consumer can also be found in the Dutch Civil Code. The Dutch Civil Code, for example, contains extensive rules as to the information which should be provided to the consumer before entering into the contract and as to the contents of the contract. The Dutch Civil Code further contains a “black and grey” list of provisions that, if included in the general conditions applicable to a contract entered into with a consumer, are considered to be (or deemed to be) unreasonably onerous towards such consumer as a result of which the consumer is able to declare the relevant provision void. Each of the lists contains several items amongst which is the provision that excludes the consumer’s right to set-off any amount it owes to its counterparty with any amount it owes from such counterparty.

### 1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

No, in respect of receivables owed by the government or a government agency in principle no other requirements apply to the sale or collection of such receivables. It should be noted, however, that, according to the Dutch Civil Code, any rights to which a person is entitled pursuant to private law may not be exercised contrary to the written or unwritten rules of public law. Essentially, this means that if a government entity or agency exercises any rights to which it is entitled pursuant to rules or principles of private law, such entity always needs to act in accordance with so-called general principles of good management (*algemene beginselen van behoorlijk bestuur*), which should always serve as a guiding principle for government entities, and may even limit such government entity’s ability to act as it considers fit if doing so would constitute improper management. Furthermore, it should be noted that, according to well-established case law, a government entity or agency may not exercise any rights which it may have under private law to serve any public interests, to the extent that public law grants such entity sufficient powers to realise such public goals. To the extent that any public regulation does not sufficiently provide for such means, the exercise of such rights provided under private law may not thwart the public law provisions in an unacceptable manner.

## 2 Choice of Law - Receivables Contracts

### 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in the Netherlands that will determine the governing law of the contract?

If the parties to a contract have not specified the law applicable to such contract, the applicable law will be determined on the basis of article 4 of the EC Regulation on the law applicable to contractual obligations of 17 June 2008 (“**Rome I**”). Article 4(1) specifies the applicable law for certain particular types of contract listed therein, such as a contract for the sale of goods (which shall be governed by the law of the country where the seller has his habitual residence), a franchise contract (which shall be governed by the law of the country where the franchisee has his habitual residence) and a distribution contract (which shall be governed by the law of the country where the distributor has his habitual residence). Where the

contract cannot be categorised as being one of the specified types of contract, it will be governed by the law of the country where the party required to effect the characteristic performance (*kenmerkende prestatie*) of the contract has his habitual residence (article 4(2) of Rome I).

There are certain exceptions to the aforementioned rules. Pursuant to article 4(3) of Rome I, if it appears, from all the circumstances of the case, that the contract is manifestly more closely connected (*nauwst verbonden*) with a country other than that indicated in article 4(1) or 4(2), the law of the other country shall apply. In addition, article 4(4) of Rome I stipulates that if parties to a contract have not specified the law applicable to such contract, the contract cannot be categorised as being one of the types of contract as specified in Rome I and in the absence of a characteristic performance of a contract, the contract should be governed by the law of the country with which it is most closely connected (*nauwst verbonden*). In order to determine the country to which the contract is more or most closely connected, the relationship between the contract in question and other contracts should be taken into account.

Furthermore, Rome I contains some provisions with respect to the law applicable to contracts of carriage, consumer contracts, insurance contracts and individual employment contracts (articles 5 to 8 of Rome I). If a professional has entered into a contract with a consumer and there is no choice of law specified in the contract, pursuant to article 6(1) of Rome I, such contract will, despite the law applicable pursuant to article 4 of Rome I, be governed by the law of the country where the consumer has his habitual residence, provided that the professional pursues or directs his commercial activities in, or to this, country. If there is a choice of law specified in the contract with a consumer then this choice of law will not set aside the non-dispositive consumer protection rules of the law of the country in which the consumer has his residence.

In the Dutch Civil Code, it is explicitly stated that if it concerns a credit agreement with a consumer (excluding, *inter alia*, mortgage loans), which has a close connection with one or more of the Member States of the European Union, the consumer protecting rules on the basis of the Consumer Credit Directive (Directive 2008/48/EC) cannot be set aside, irrespective of the law governing the credit agreement.

### 2.2 Base Case. If the seller and the obligor are both resident in the Netherlands, and the transactions giving rise to the receivables and the payment of the receivables take place in the Netherlands, and the seller and the obligor choose the law of the Netherlands to govern the receivables contract, is there any reason why a court in the Netherlands would not give effect to their choice of law?

No, the choice of Dutch law as the law governing the contract will be valid and binding and be recognised by a Dutch court.

### 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in the Netherlands but the obligor is not, or if the obligor is resident in the Netherlands but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in the Netherlands give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Under Dutch law, the seller and the obligor are free to choose the law to govern the receivable contract to be entered into by them,



including the law of any relevant jurisdiction (other than the Netherlands) (“**Foreign Law**”), and this choice of law is valid and binding as between the seller and the obligor, except that a Dutch court may give effect: (i) to the extent that any term of the relevant receivable contract or any provision of Foreign Law applicable to such receivable contract is manifestly incompatible with the overriding mandatory provisions of the Netherlands or of another jurisdiction where the performance of the relevant receivable contract takes place or must take place and which render such performance unlawful, such overriding mandatory provisions; (ii) if all other elements relevant to the situation at the time of the choice of law are located in the Netherlands or in another jurisdiction, mandatory rules of Dutch law or of the laws of another jurisdiction, if and insofar as, under Dutch law or of the laws of that other jurisdiction, those rules must be applied irrespective of the chosen law; and (iii) in case the Foreign Law is of a jurisdiction which is not a Member State of the EU and all other elements relevant to the situation at the time of the choice of law are located in one or more Member State(s) of the EU, the mandatory rules of European Community Law (*gemeenschapsrecht*), as implemented by the relevant Member State(s), if and insofar as, such European Community Law must be applied irrespective of the chosen law. Furthermore, the application of a provision of Foreign Law may be refused by a Dutch court if such application is manifestly incompatible with the public policy of Dutch law.

#### 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in the Netherlands?

Yes, as of 1 January 1991, the United Nations Convention on the International Sale of Goods is in effect in the Netherlands.

### 3 Choice of Law - Receivables Purchase Agreement

#### 3.1 Base Case. Does the Netherlands’ law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., the Netherlands’ laws or foreign laws)?

Pursuant to Dutch private international law, the assignment of a receivable will be governed by the chosen law of, or the law otherwise applicable to, the agreement which contains the undertaking to assign such receivable, irrespective of the law governing the receivable. The law of the agreement containing the undertaking determines the validity of the assignment of the receivable. However, the law governing the receivable which is purported to be assigned determines the topics set forth in article 14(2) of Rome I, being (i) the assignability of the receivable, (ii) the relationship between the assignee and the obligor, (iii) the conditions under which the assignment of the receivable can be enforced against the obligor, as well as (iv) the question of whether the obligor’s obligations under the receivable have been paid and discharged in full.

#### 3.2 Example 1: If (a) the seller and the obligor are located in the Netherlands, (b) the receivable is governed by the law of the Netherlands, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the Netherlands to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the Netherlands, will a court in the Netherlands recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes, a Dutch court would recognise an assignment of a receivable executed between such seller and purchaser in accordance with Dutch law, pursuant to a receivables purchase agreement which is governed by Dutch law, as being effective against the seller, obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor), subject of course to the provisions of any applicable bankruptcy (*faillissement*), insolvency, fraudulent conveyance (*actio pauliana*), reorganisation, suspension of payments (*surseance van betaling*) and other laws of general application in effect, relating to or affecting the enforcement or protection of creditors’ rights.

#### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside the Netherlands, will a court in the Netherlands recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Yes, a Dutch court would recognise an assignment of a receivable executed between such seller and purchaser in accordance with Dutch law, pursuant to a receivables purchase agreement which is governed by Dutch law, as being effective against the seller and third parties (such as creditors or insolvency administrators of the seller) irrespective of whether or not the requirements for assignment under the law of the obligor’s or purchaser’s country (or both) have been taken into account, subject of course to the provisions of any applicable bankruptcy (*faillissement*), insolvency, fraudulent conveyance (*actio pauliana*), reorganisation, suspension of payments (*surseance van betaling*) and other laws of general application in effect, relating to, or affecting, the enforcement or protection of creditors’ rights.

#### 3.4 Example 3: If (a) the seller is located in the Netherlands but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in the Netherlands recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with the Netherlands’ own sale requirements?

Yes, a Dutch court would recognise an assignment of a receivable executed between such seller and purchaser in accordance with the law governing the receivables purchase agreement as being effective against the seller and third parties of the seller, irrespective of whether or not the requirements for assignment under Dutch law have been complied with, subject of course to the provisions of any applicable

bankruptcy (*faillissement*), insolvency, fraudulent conveyance (*actio pauliana*), reorganisation, suspension of payments (*surseance van betaling*) and other laws of general application in effect, relating to or affecting the enforcement or protection of creditors' rights.

**3.5 Example 4: If (a) the obligor is located in the Netherlands but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in the Netherlands recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with the Netherlands' own sale requirements?**

Yes, a Dutch court would recognise an assignment of a receivable executed between such seller and purchaser in accordance with the law governing the receivables purchase agreement as being effective against the obligor and third parties of the obligor, irrespective of whether or not the requirements for assignment under Dutch law have been complied with, subject of course to the provisions of any applicable bankruptcy (*faillissement*), insolvency, fraudulent conveyance (*actio pauliana*), reorganisation, suspension of payments (*surseance van betaling*) and other laws of general application in effect, relating to or affecting the enforcement or protection of creditors' rights.

**3.6 Example 5: If (a) the seller is located in the Netherlands (irrespective of the obligor's location), (b) the receivable is governed by the law of the Netherlands, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in the Netherlands recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in the Netherlands and any third party creditor or insolvency administrator of any such obligor)?**

Yes, a Dutch court would recognise an assignment of a receivable executed between such seller and purchaser in accordance with the law governing the receivables purchase agreement as being effective against the seller, any obligor located in the Netherlands and third parties of the seller and such obligor, subject of course to the provisions of any applicable bankruptcy (*faillissement*), insolvency, fraudulent conveyance (*actio pauliana*), reorganisation, suspension of payments (*surseance van betaling*) and other laws of general application in effect, relating to or affecting the enforcement or protection of creditors' rights. However, Dutch law would determine the conditions under which such assignment can be enforced against the obligor (see the answer to question 3.1 above).

## 4 Asset Sales

**4.1 Sale Methods Generally. In the Netherlands what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

The customary method for a seller to transfer receivables in the Netherlands would be a sale (*verkoop*) of such receivables by

entering into a sale and purchase agreement with the purchaser followed by an assignment (*cessie*) of such receivables pursuant to which the purchaser becomes the legal owner of such receivables.

As set forth under question 4.2 below, Dutch law makes a distinction between the undertaking to transfer a receivable constituting the title (*titel*) required for a valid transfer (*overdracht*) of a receivable and the delivery (*levering*) of such receivable (named assignment (*cessie*)) pursuant thereto.

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

Pursuant to section 3:84(1) of the Dutch Civil Code, the transfer of ownership of assets (which includes receivables) requires delivery (*levering*), pursuant to a valid title (*geldige titel*), by a person who has the power of disposal over the assets (*beschikkingsbevoegdheid*). The title required for the assignment of receivables may be constituted by a receivables purchase agreement between the seller and the purchaser. For the delivery of receivables, section 3:94(1) of the Dutch Civil Code requires: (i) a deed of assignment signed by the assignor and accepted by the assignee (which acceptance is free of form); and (ii) notification to the relevant obligors of the assignment. Pursuant to section 3:94(3) of the Dutch Civil Code, which was added to the Dutch Civil Code on 1 October 2004, an assignment of receivables can also be effected by means of a notarial deed of assignment or a private deed of assignment that is registered with the Dutch tax authorities, without notification of the assignment to the relevant obligors being required, provided that such receivables exist at the time of registration or directly result from an existing legal relationship (*rechtstreeks zullen worden verkregen uit een bestaande rechtsverhouding*). However, notification to the obligors will still be required so that such obligors can no longer validly discharge their obligations (*bevrijdend betalen*) under the receivables by paying the seller.

There are no additional or other formalities required for the transfer of receivables to be perfected against any subsequent good faith purchasers. In case of *multiple* assignments by the same assignor according to Dutch law the second assignee will, in principle, not be protected against the first assignment, regardless of whether the second assignee acted in good faith or not and provided the first transfer was completed. This would only be different in case the second assignee could successfully invoke the general third party protection clause of section 3:36 of the Dutch Civil Code. Pursuant to this clause, a third person who, on the basis of another's declaration or conduct, assumes the creation, existence or extinction of a certain juridical relationship which is reasonable in the circumstances, and who acts reasonably in reliance on the accuracy of that assumption, cannot have the inaccuracy of that assumption invoked against him by the other person. Although it would technically be possible for a second assignee to be protected against the lack of power of disposition of the seller following the first transfer of the receivable, it will not be easy to comply with the above requirements in order to be so protected.

**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

The law on negotiable instruments such as a promissory note is set forth in the Dutch Commercial Code (*Wetboek van Koophandel*). The relevant provisions of this Code reflect, for the most part, the terms of

the 1930 and 1931 Geneva Conventions to which the Netherlands is party. However, it is of note that these statutory rules only apply to a promissory note payable to order (provided such instrument does contain the elements which are required according to the Dutch Commercial Code in order to qualify as a negotiable instrument within the meaning thereof). A promissory note payable to order must state the name of the person to whom or to whose order payment must be made. Under Dutch law a promissory note payable to order is transferred by means of physical delivery of the instrument to the endorsee (*geëndosseerde*) and an endorsement to be written on (the back of) the promissory note itself or on a slip affixed thereto (*verlengstuk*). Such delivery must be effectuated pursuant to a valid title by a person who has the power to dispose over the instrument.

A promissory note payable to bearer is governed by the principles of Dutch law regarding bearer instruments in general. A transfer of ownership of a bearer instrument requires a delivery by means of the provision of the possession (*bezitsverschaffing*) of the instrument to the purchaser pursuant to a valid title by a person who has the power to dispose of the instrument.

Pursuant to Dutch rules of private international law, the proprietary aspects (such as a transfer) of book-entry securities (*girale effecten*) held in a securities account with a bank or other entity, which is allowed to offer securities accounts to its customers are governed by the laws of the state in whose territory the relevant bank maintains the securities account to which such securities are credited. Such laws specifically determine (i) which proprietary rights can be vested in the securities as well as the nature and contents of such rights, (ii) the perfection requirements for a transfer of the securities or for the vesting of a proprietary right therein, (iii) who is entitled to exercise the rights attached to the securities, (iv) the manner in which the contents of proprietary rights in the securities can vary, the manner in which proprietary rights in the securities pass by operation of law (*overgaan*) and the manner in which proprietary rights in the securities terminate and what the mutual relationship is between various proprietary rights, and (v) how to foreclose upon the securities.

Under Dutch law, securities held through and registered with Euroclear Netherlands will be transferred in accordance with the Securities Giro Act (*Wet Giraal Effectenverkeer* or “Wge”) by means of a simple book entry in the name of the purchaser at the relevant bank.

There are no additional or different requirements for the sale and assignment of receivables resulting from consumer loans and mortgage loans.

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?**

The effectiveness of the assignment of receivables should be distinguished from the enforceability of such assignment against the obligors. With respect to the assignment of receivables, as set out in our answer to question 4.2, Dutch law requires a deed of assignment and (a) notification thereof to the obligors (assignment pursuant to section 3:94(1) of the Dutch Civil Code), or (b) registration of the deed of assignment with the Dutch tax authorities (assignment pursuant to

section 3:94(3) of the Dutch Civil Code). Only in case of a disclosed assignment – i.e. an assignment under (a) – is notification required for an assignment of the receivables to be effective. As regards the enforceability of such assignment of receivables against the obligors of the receivables, notification of such obligors of such assignment will be required (both in case of a disclosed and non-disclosed assignment) in order to prevent, *inter alia*, the obligor from validly discharging his obligations under the receivables by paying to the seller. Further, pursuant to section 7:69(2) of the Dutch Civil Code, which applies if it concerns consumer credit agreements (excluding, *inter alia*, mortgage loans), the consumer should be informed about an assignment. This rule, however, does not apply if the original credit provider will manage the credit agreement after the assignment.

Under Dutch law, the obligor's consent as to an assignment of a receivable is not required, unless the relevant receivables contract does prohibit such assignment without the obligor's consent, or contains other restriction clauses on the assignment of the receivables. See the answer to question 4.7 below.

In case of a non-disclosed assignment, prior to notification being made, an obligor can only validly discharge its obligations (*bevrijdend betalen*) under the relevant receivable by paying to the seller. Any payments made by the obligor to the seller after the date on which the seller has been declared bankrupt (*failliet verklaard*) or has been granted a suspension of payments (*surseance van betaling verleend*), but prior to notification having been made, will form part of the bankruptcy estate of the seller, albeit that the purchaser will be a ‘creditor of the estate’ (*boedelschuldeiser*) in respect of such payments. This risk no longer exists after notification is made; as from that moment, the obligor can only validly discharge its obligations by making a payment to the purchaser.

Under Dutch law, a debtor has a right of set-off (*verrekening*) if he has a claim which corresponds to his debt to the same counterparty and he is entitled to pay his debt as well as to enforce payment of his claim. Unless the set-off right is effectively waived by an obligor in the underlying receivables contract, prior to notification being made, such obligor will, provided that the statutory requirements for set-off are met, be entitled to set-off any amounts due by the seller to it with any receivables owed by it to the seller. After notification of the assignment, the obligor will have such right of set-off *vis-à-vis* the purchaser, provided that the statutory requirements for set-off are met (except for the requirement of mutual creditorship), and further provided that (i) the counterclaim of the obligor results from the same legal relationship as the relevant receivable, or (ii) the counterclaim of the obligor has been originated (*opgekomen*) and become due (*opeisbaar*) prior to the assignment of the receivable and notification thereof to the obligor. It is of note that, under Dutch law, a waiver of set-off rights is not enforceable in all circumstances, in particular not when the obligor qualifies as a private individual not acting in the course of its business or profession.

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

The relevant sections of the Dutch Civil Code do not contain any formal requirements as to how notification of an assignment to the

obligor must take place or the form thereof. Notification may, in principle, even be done orally. However, it is advisable to deliver a notice in writing. A notification of an assignment will only be completed upon receipt by the obligor of the relevant notice, except if a failure to receive notice is deemed to be for the risk of such obligor (e.g., in case the obligor has changed location and did not inform its creditors thereof). It is possible to notify an obligor by one single notice of the assignment of any and all receivables which the seller currently has, or may acquire in the future, against such obligor.

Under Dutch law, the purchaser may notify the obligor of the sale and assignment of the receivables at all times, even after the bankruptcy (*faillissement*) or suspension of payments (*surseance van betaling*) of the seller or the obligor. However, it should be noted that, in case of an assignment pursuant to section 3:94(1) of the Dutch Civil Code, which requires notification, notification on or after the date the seller has been declared bankrupt (*failliet verklaard*) or granted suspension of payments (*surseance van betaling verleend*) will not be effective. Consequently, in such event, the legal ownership to the receivables will not pass to the purchaser. Furthermore, in case of an assignment pursuant to section 3:94(3) of the Dutch Civil Code, which requires notification to the obligors in order to prevent the obligors to validly discharge their obligations (*bevrijdend betalen*) under the receivables by paying to the seller, any payments made by the obligor to the seller after the date on which the seller has been declared bankrupt (*failliet verklaard*) or has been granted a suspension of payments (*surseance van betaling verleend*), but prior to notification having been made, will form part of the bankruptcy estate of the seller, albeit that the purchaser will be a 'creditor of the estate' (*boedel schuldeiser*) in respect of such payments.

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?**

Pursuant to Dutch private international law the interpretation of the receivables contract is governed by the law applicable to that contract (article 12(1)(a) Rome I; see, as to the applicable law, the answers to section 2 above).

Under Dutch law, the interpretation of an agreement is not limited to a literal interpretation of the wording of the agreement. In interpreting an agreement, a Dutch court will also take into account the meaning that the parties in the given circumstances could reasonably ascribe to the provisions of the agreement and what the parties could reasonably expect from each other. All relevant circumstances should be taken into account, including the sophistication of the parties. However, in interpreting an agreement a Dutch court will, in most cases, take the wording of an agreement as a starting point.

A contractual provision stating that none of the seller's rights or obligations may be transferred or assigned without the consent of the obligor, will in principle be interpreted as prohibiting a transfer of receivables, unless with the consent of the obligor.

A contractual provision stating that the agreement may not be transferred or assigned by the seller without the consent of the obligor, will in principle not be interpreted as prohibiting a transfer

of receivables as the wording of this provision only refers to the transfer of the agreement. However, the obligor may argue that based on the circumstances of the case (e.g., negotiations) he could rightfully interpret the relevant provision in such a manner that the provision also prohibits a transfer of receivables.

**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in the Netherlands? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If the Netherlands recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

Under Dutch law, restrictions in receivables contracts prohibiting sale or assignment are generally enforceable. It does not make a difference if a contract is entered into with commercial entities or with persons not acting in the course of their profession or business.

In the event that a receivables contract, which is governed by Dutch law, does prohibit assignment of the receivables, or otherwise contains restriction clauses on the assignment of such receivables, this would, in the current interpretation given to such clauses in Dutch case law, affect the validity of the assignment of such receivables pursuant to section 3:83(2) of the Dutch Civil Code. Under Dutch private international law, the question of whether a receivable is transferable is governed by the law governing such receivable (see the answer to question 3.1 above). This means that if the receivables contract, which is governed by Dutch law, prohibits assignment or otherwise contains any restrictions on the assignment of receivables, this would affect their transferability. For the avoidance of doubt, a breach of a restriction clause would affect the transfer itself; in other words there will be no valid transfer of the relevant receivables. Therefore, the question of whether the seller will be liable for breach of contract is not relevant.

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

It is a Dutch law requirement that the receivables to be assigned pursuant to a deed of assignment are identifiable on the basis of such deed. According to case law, this requirement is satisfied if the deed does contain such details in respect of the relevant receivables that one can determine which receivables the parties have intended to assign. In order to avoid any discussions (either between the parties, or more in particular with any bankruptcy trustee) as to whether or not certain receivables have been validly assigned, it is preferred that as much detail as possible is included in the deed of assignment (such as invoice numbers). However, based on case law, it is possible to make use of a more general description, e.g., all receivables that are recorded in the books of the seller on the date of assignment.

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

Under Dutch law, legal title to a receivable will pass to the purchaser if such receivable is validly delivered by the seller pursuant to a valid title (*geldige titel*) and the seller had the power of disposal (*beschikkingsbevoegdheid*) over such receivable. Upon the purchaser becoming the legal owner of the receivable, the receivable becomes part of the purchaser's estate. In principle (i.e., subject to fraudulent conveyance and similar principles of Dutch law), the creditors of the seller (or its insolvency official) would not be able to recover receivables that have become part of the purchaser's estate.

In relation to the requirement of a valid title (*geldige titel*), the obligation for the seller being to sell and assign the receivable, generally to be constituted by a receivables purchase agreement, we first note that according to a judgment of the Netherlands Supreme Court dated 13 March 1981 (HR 13 March 1981, NJ 1981, 635, *Haviltex*) the intention of the parties is of great importance to assess and interpret the terms and conditions of an agreement. If it is the intention of the parties involved to have a sale and assignment of a receivable and such is stipulated in the receivables purchase agreement, this will most likely be respected by a court. However, only in cases where it is evident that the intention of the parties is different from what is stated in the agreement, which is dependent on all relevant circumstances (including the economic characteristics of an agreement), a court could come to the conclusion that no sale and assignment of the receivable is foreseen and that a valid title for the assignment of the receivable is missing.

Secondly, we note that section 3:84(3) of the Dutch Civil Code provides that an agreement which purports to transfer an asset as security for a liability or which does not purport the transferred assets to become part of the assets of the transferee, does not constitute a valid title. The fact that it has been agreed between the seller and the purchaser that the seller retains the whole credit risk related to the assigned receivables, that the purchaser is entitled to re-transfer all defaulted or uncollectable receivables to the seller, that the purchase price payable by the purchaser is equal to the amounts which are actually collected from the obligors or that the seller is entitled to repurchase the assigned receivables may, depending on the circumstances, involve the risk that the sale agreement is not considered to constitute a valid title, especially if the purchaser does not accept the insolvency risk relating to the debtors of the receivables and the agreement is to be regarded as merely a financing arrangement. However, this risk is considered to be remote since case law, in particular the judgment of the Netherlands Supreme Court dated 19 May 1995 (HR 19 May 1995, NJ 1996, 119, *Mr. Keereweer q.q. Sogelease*) has limited the effects of the restrictions resulting from section 3:84(3) of the Dutch Civil Code considerably. According to this judgment, only the transfer of ownership for the sole purpose of protecting the interests of the transferee as a creditor of the transferor constitutes an invalid title (*fiducia cum creditore*).

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

Yes, a seller may agree to a sale of all receivables that it currently owes and may owe in the future, subject of course to provisions of any applicable insolvency, fraudulent conveyance (*actio pauliana*) and other laws of general application in effect at the time of the agreement or thereafter, relating to or affecting the enforcement or protection of creditor's rights.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?**

Under Dutch law, a receivable which does not exist yet may be sold and assigned in advance (*bij voorbaat*) by the seller so that the purchaser automatically becomes the owner thereof when it comes into existence, provided that the receivable is sufficiently identifiable on the basis of the deed of assignment and the requirements for the transfer of ownership are met. If the assignment is effected pursuant to section 3:94(1) of the Dutch Civil Code, the assignment of a "future" receivable has to be notified to the relevant obligors and, if the assignment is effectuated pursuant to section 3:94(3) of the Dutch Civil Code, the legal relationship from which such receivable results must already exist at the time of the assignment in advance. However, it is of note that an assignment of a future receivable will not be effective to the extent that the receivable comes into existence after, or on, the date on which the seller has been declared bankrupt or has had a suspension of payments granted to it.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

No additional formalities need to be fulfilled if the related security qualifies as an accessory right (*afhankelijke recht*) in the meaning of section 3:7 of the Dutch Civil Code and/or ancillary right (*nevenrecht*) in the meaning of section 6:142 of the Dutch Civil Code, such as a mortgage right, right of pledge or suretyship (*borgtocht*). Pursuant to sections 3:82 and 6:142 of the Dutch Civil Code, accessory rights and ancillary rights follow the right with which they are connected. Consequently, if a receivable is assigned, in principle the accessory rights and the ancillary rights pass by operation of law to the assignee of the receivable upon completion of the assignment, except if the relevant right by its nature is, or has been construed by the parties as, a purely personal right of the assignor. If a security right is not solely granted to secure a particular receivable, but it secures also other amounts that are or may become due by the relevant obligor, it is not entirely certain whether upon assignment of the receivable such security right follows the relevant receivable, although there are good arguments that such security right will *pro rata parte* pass to the assignee.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

On the basis of sections 3:94(3) and 6:130(1) of the Dutch Civil Code, notification of the assignment will limit the *statutory* right of set-off. After notification of the assignment, the obligor will have a right of set-off *vis-à-vis* the purchaser in respect of a counterclaim against the seller, provided that the statutory requirements for set-off are met (except for the requirement of mutual creditorship), and further provided that (i) the counterclaim of the obligor results from the same legal relationship as the relevant receivable, or (ii) the counterclaim of the obligor has been originated (*opgekomen*) and become due (*opeisbaar*) prior to the assignment of the receivable and notification thereof to the obligor. In respect of this limitation of the statutory right of set-off neither the seller nor the purchaser will be liable to the obligor.

In case of a *contractually* agreed upon right of set-off, a notification of assignment will not limit such right of set-off.

If the assigned receivable results from a consumer credit agreement (excluding, *inter alia*, mortgage loans), pursuant to section 7:69(1) of the Dutch Civil Code, the consumer is entitled to assert against the purchaser any defence which was available to him against the seller, including a right of set-off.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in the Netherlands to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

No, it is not customary in Dutch transactions involving a sale of receivables to take up such a "back-up" security interest.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of the Netherlands, and for such security interest to be perfected?**

See the answer to question 5.1 above.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in the Netherlands to grant and perfect a security interest in purchased receivables governed by the laws of the Netherlands and the related security?**

A right of pledge over receivables (including, without limitation, accounts receivable) is created by the execution of a deed of pledge. Under Dutch law, a right of pledge over receivables can either be a disclosed pledge (*openbaar pandrecht*), in which case the obligor of the pledged receivables is given notification of the pledge, or an undisclosed right of pledge (*stil pandrecht*), in which case the

obligor is not notified of the pledge. However, in order to create a valid undisclosed right of pledge, the relevant deed of pledge must be in the form of a notarial deed executed before a Dutch civil law notary, or registered with the Dutch tax authorities.

No statutory provision exists on the issue whether, upon the creation of a right of pledge over a receivable and notification thereof to the relevant obligor, the pledgee is entitled to exercise the accessory rights and the ancillary rights (such as security rights) connected to the receivable upon the exercise of the right of pledge. However, the majority view is that, if a right of pledge is created over a receivable which itself is secured by a mortgage or a pledge, the pledgee is entitled to exercise the rights of the relevant pledgor under such mortgage or pledge, provided that the pledge of the receivable is disclosed to the relevant obligor.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of the Netherlands, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in the Netherlands or must additional steps be taken in the Netherlands?**

The statements made under question 3.1, above, apply *mutatis mutandis*. This means that the granting of a security right over a receivable will be governed by the chosen law of, or the law otherwise applicable to, the agreement which contains the undertaking to grant a security right over such receivable, irrespective of the law governing the receivable. The law of the agreement containing the undertaking determines the validity of the granting of a security right over the receivable. However, the law governing the receivable over which a security right is purported to be granted determines (i) whether the receivable is capable of being encumbered, (ii) the relationship between the grantee of the security right and the obligor, (iii) the conditions under which the granting of a security right over the receivable can be enforced against the obligor, as well as (iv) the question as to whether the obligor's obligations under the receivable have been paid and discharged in full.

Subject to similar exceptions to the validity of the choice of the law of the purchaser's country or a third country (other than the Netherlands) as referred to in our answer to question 2.3 above and the above paragraph, such foreign security rights will be recognised in the Netherlands, without any additional steps being required.

It is of note that there is no conclusive case law in the Netherlands with respect to the enforcement by the Dutch courts of security rights established under, and governed by, a law other than Dutch law. However, from Dutch case law as it currently stands, it can be deduced that, if recognised, a foreign security right will be enforced and have the same ranking as the Dutch security right which most closely resembles such foreign security right. This means that the secured party will not have more rights than it would have had if Dutch law had governed such security right.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

Under Dutch law, a right of pledge over a promissory note payable to the bearer is created by (i) the pledgor and the pledgee entering into a pledge agreement, and by the physical delivery of the instrument to the pledgee or a third party agreed upon by the pledgor and the pledgee or by (ii) a notarial or registered deed without physical delivery. A right of pledge over a promissory note payable to order is created in the manner mentioned under (i), provided that in addition to that, an

endorsement is written on (the back of) the promissory note itself or on a slip affixed thereto (*verlengstuk*).

If the marketable debt securities held by the seller are cleared through and registered with Euroclear Netherlands pursuant to the Wge, then a pledge over these securities is effectuated by means of a simple book entry in the name of the pledgee at the relevant bank's records. We note however that, pursuant to Dutch rules of private international law, the law governing the creation of a security interest in securities held in a securities account with a bank or other entity, which is allowed to offer securities accounts to its customers, is the laws of the state in whose territory the relevant bank maintains the account to which such securities are credited.

There are no additional or different requirements for the creation and perfection of a right of pledge over receivables resulting from consumer loans and mortgage loans.

---

**5.6 Trusts. Does the Netherlands recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

---

Dutch law does not know the legal concept of trusts. However, under Dutch law, pursuant to the Trust Convention, a trust created in accordance with the chosen law, will be recognised by the courts in the Netherlands, provided that the chosen law provides for trusts and the trust has been created voluntarily and is evidenced in writing. Pursuant to section 13 of the Trust Convention, the courts in the Netherlands will, however, not be bound to recognise a trust, the significant elements of which are more closely connected with states which do not provide for the institution of the trust. As an alternative to a trust, a bankruptcy remote foundation may be used, which is incorporated for the sole purpose of managing and for the distribution of certain amounts received by it to the persons who are entitled to receive such amounts in accordance with the object clause in its articles of association.

---

**5.7 Bank Accounts. Does the Netherlands recognise escrow accounts? Can security be taken over a bank account located in the Netherlands? If so, what is the typical method? Would courts in the Netherlands recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in the Netherlands?**

---

The legal concept of escrow accounts does not exist under Dutch law. However, regular bank accounts in which amounts are credited which have a special purpose are being used frequently (especially in cases of sale and transfer of real estate). In case such an account is maintained by a notary and qualifies as a so-called designated account (*kwaliteitsrekening*), the amounts standing to the account are separated from the estate of the notary.

A right of pledge over accounts receivables is generally created as a disclosed pledge (*openbaar pandrecht*) by the execution of a deed of pledge and notification thereof to the account bank. It should be noted that, pursuant to the general banking conditions (*algemene bankvoorwaarden*), the account bank generally retains a right of pledge in respect of the account and that, in case a first ranking right of pledge over account receivables is envisaged, the account bank should be contacted and requested to waive the right of pledge created in favour of the account bank.

As to the recognition of a foreign law security right in respect of a bank account located in the Netherlands, see the answer to question 5.4 above.

---

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

---

In principle, all present and future accounts receivables of the account owner against an account bank are subject to the disclosed pledge (*openbaar pandrecht*) after notification of such financial institution. An undisclosed right of pledge (*stil pandrecht*) does not cover future accounts receivables, but is limited to the amounts standing to the account at the time the right of pledge is vested. As a result, in case of an undisclosed right of pledge the owner of the account (the pledgor) has access to the funds in the account even after enforcement of the pledgee's undisclosed right of pledge. Therefore, it is preferable to create a disclosed right of pledge over the accounts receivables as such limitation does not apply to enforcement of a disclosed pledge.

Pursuant to section 3:246(1) of the Dutch Civil Code the pledgee is entitled to collect the pledged accounts receivables in and out of court. The account bank can only validly discharge its obligations (*bevrijdend betalen*) by paying the pledgee. When a pledged claim is collected by the pledgee, the right of pledge is automatically vested on the collection proceeds. Pursuant to section 3:255 of the Dutch Civil Code the pledgee is entitled to recover his claim from the collection proceeds as soon as his claim has become due and payable. Until the claim has become due and payable, the collection proceeds must be held separated from the pledgee's private estate. The pledgee and the account owner (pledgor) could agree in the deed of pledge that as soon as the pledged claim becomes due and payable, the claim of the pledgee will become due and payable for an equal amount as the pledged claim.

The right to demand payment in and out of court and to collect the pledged accounts receivables stays with the account owner (pledgor) as long as the account bank is not notified of the right of the pledge. Hence, in case an undisclosed right of pledge (*stil pandrecht*) is created over the accounts receivables, the pledgee is only entitled to demand payment and to collect the pledged accounts receivables after notification of the right of pledge to the relevant obligor.

A pledge over a bank account will not cover any payments that are made into the bank account after bankruptcy (*faillissement*) or suspension of payments (*surseance van betaling*) of the owner of the account (pledgor).

---

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

---

A distinction must be made between a disclosed pledge (*openbaar pandrecht*) and an undisclosed pledge (*stil pandrecht*).

As set forth under question 5.8 the pledgee under a disclosed right of pledge is, in principle, entitled to demand payment and to collect the pledged accounts receivables pursuant to section 3:246 of the Dutch Civil Code. The account owner (pledgor) is only entitled to exercise the rights to demand payment and to collect the accounts receivables with approval of the pledgee or with authorisation of a Dutch district court. Until the claim of the pledgee becomes due and payable, the pledgee's interest to demand payment and to collect the pledged accounts receivables will, however, not be that substantial. Therefore, in practice, the pledgee will occasionally give such approval to the account owner (pledgor).

In case of an undisclosed pledge (*stil pandrecht*) the right to demand payment in and out of court and to collect the pledged accounts receivables stays with the account owner (pledgor) until the account bank is notified of the right of the pledge. Until such notification, the account holder will have access to the funds in the bank account without affecting the security.

## 6 Insolvency Laws

### 6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will the Netherlands insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

If the seller of receivables under Dutch law becomes subject to insolvency proceedings following the sale and transfer of ownership rights in such receivables, the purchaser of these receivables is free to exercise any ownership rights over the receivables (including collection and transfer). Dutch law is not familiar with any “automatic stay” provisions which a purchaser would have to comply with following an effective sale and transfer of receivables (or a true sale, if you like) in such circumstances.

It should be noted in this respect that Dutch law makes a distinction between ‘existing’ and ‘future’ receivables: if receivables are to be regarded as future receivables, a transfer will be ineffective to the extent that the receivables come into existence on or after the date on which the seller has been declared bankrupt or has had a suspension of payments granted to it (see question 4.11 above). The purchaser will, in that case, not be able to exercise any ownership rights as such rights have not been effectively transferred to it.

In case of an *undisclosed* assignment pursuant to section 3:94(3) of the Dutch Civil Code (see question 4.2) until notification to the obligors has been made, such obligors can only validly discharge their obligations (*bevrijdend betalen*) under the relevant receivables contract by making a payment to the seller. Payments made by the obligors to the seller prior to notification but after bankruptcy or suspension of payments in respect of the seller having been declared, will be part of the seller’s bankruptcy estate. However, the purchaser has the right to receive the amounts paid by the obligors by preference after deduction of the general bankruptcy costs (*algemene faillissementskosten*). Notification to the obligors of the transfer of legal title can still be validly made after the seller has been declared bankrupt (*failliet verklaard*) or has been granted a suspension of payments (*surseance van betaling verleend*). After such notification, the obligors are required to make the payments under the relevant receivables contracts to the purchaser.

In case of a disclosed assignment pursuant to section 3:94(1) of the Dutch Civil Code which requires notification (see question 4.2), notification on or after the date the seller has been declared bankrupt (*failliet verklaard*) or granted suspension of payments (*surseance van betaling verleend*) will not be effective. Consequently, in such an event, the legal ownership to the receivables will not pass to the purchaser.

In case the purchaser is granted a right of pledge over the receivables, the purchaser, as pledgee, may act “as if there were no bankruptcy” and foreclose its right of pledge. A right of pledge over receivables governed by Dutch law may be enforced by collection

of such receivables (after notice of the right pledge to the relevant obligor) and applying the net proceeds of such collection in satisfaction of the payment obligations secured by such pledge or by having the receivables sold in a public auction or by a private sale and applying the net proceeds of such auction or sale towards satisfaction of the payment obligations secured by such pledge, all with due observance of the applicable provisions of Dutch law.

It should be noted that under the Dutch Bankruptcy Code (*Faillissementswet*) the court (in case of a suspension of payments (*surseance van betaling*)) or the relevant magistrate (*rechter-commissaris*) (in case of a bankruptcy), may for a period of two months with a possible extension of two months, order a general stay – a so-called ‘cool down period’ (*afkoelingsperiode*) – during which secured creditors, such as a holder of a pledge over receivables, may only foreclose its right of pledge after having obtained the approval of the court (in case of suspension of payments) or the magistrate (in case of bankruptcy). It is noted that the ordering of a cool down period does not prevent the collection by the pledgee of amounts due under the receivables, but only the application by the pledgee of the proceeds thereof towards satisfaction of the payment obligations secured by the right of pledge during the cool down period. A cool down period does not affect the exercise of a right of pledge over a ‘credit claim’ created pursuant to a financial collateral agreement, i.e., a right of pledge over a pecuniary claim resulting from an agreement under which a bank grants a credit in the form of a loan, with the exception of claims against a debtor who is a natural person and who does not act in the conduct of his business or professional practice.

Furthermore, in the case of bankruptcy, under the Dutch Bankruptcy Code (*Faillissementswet*), a bankruptcy trustee may determine a reasonable period within which pledgees and mortgagees must foreclose their security rights. If a pledgee or mortgagee fails to do so, the bankruptcy trustee may sell the assets subject to the security right himself in a manner provided for in the Dutch Bankruptcy Code (*Faillissementswet*).

### 6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

In the absence of any “automatic stay” provisions under Dutch law, and assuming the sale and transfer of the ownership rights in the receivables would be effective, the insolvency official could seek to prohibit the exercise of such ownership rights by the purchaser by having the sale and transfer of the receivables to the purchaser avoided under the Dutch fraudulent conveyance provisions (see question 6.3). Alternatively, such insolvency official could try to avoid the sale and transfer on the basis of general defences under Dutch law in respect of the validity and enforceability of contractual obligations, such as avoidance on the grounds of duress (*bedreiging*), deceit (*bedrog*), undue influence (*misbruik van omstandigheden*), or mistake (*dwaling*).

### 6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in the Netherlands for (a) transactions between unrelated parties, and (b) transactions between related parties?

The insolvency official may, on the basis of section 42 of the Dutch Bankruptcy Act (*Faillissementswet*), try to void voluntarily



executed transactions (i.e., the seller was under no obligation to enter into the transaction), provided he can establish that both parties to the transaction – seller and purchaser – knew or should have known that the transaction would have the effect of decreasing the amount which the seller's creditors would have received, had the sale and transfer of the receivables to the purchaser not taken place. This is not limited to transactions executed within a specific 'suspect period'. However, the knowledge of the parties referred to above is presumed by law, subject to proof to the contrary, for all transactions performed within one year prior to an adjudication of bankruptcy of the seller, and provided it can also be established that the transaction falls within one of the following categories:

- (i) the seller received substantially less than the estimated value of the assets sold;
- (ii) the transaction was entered into by the seller as a natural person, with certain of his/her next of kin;
- (iii) the transaction was entered into by the seller as a legal entity with members of its management board and/or supervisory board and/or its shareholders and some of each of their next of kin; or
- (iv) the transaction was entered into by the seller as a legal entity with a group company.

In case the seller entered into the transaction pursuant to an (at that time) existing legal obligation, such transaction can, pursuant to section 47 of the Dutch Bankruptcy Act, only be voided if the insolvency official proves that (a) the seller and the purchaser conspired to favour the purchaser to the detriment of the other creditors, or (b) the purchaser was aware of a bankruptcy petition having been filed against the seller. The right of the insolvency official to challenge a legal act on the basis of section 47 of the Dutch Bankruptcy Act is not limited to a specific clawback period.

---

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

---

Dutch law is not familiar with the concept of "consolidation of assets and liabilities" of the purchaser with those of the seller. If the sale and transfer of the receivables is perfected under Dutch law and the purchaser has obtained full legal title to such receivables, the insolvency official in the seller's insolvency will not be able to consolidate assets and liabilities of the purchaser with those of the seller. Should the sale and transfer of the receivables not be perfected prior to the insolvency of the seller, the receivables will fall in the seller's bankruptcy. As a practical matter, however, a bankruptcy trustee in a Dutch bankruptcy would sometimes apply consolidation of assets and liabilities, e.g., in the event that affiliated entities are declared bankrupt (i.e., a parent company and its subsidiaries), there would be a strong interrelationship among these entities (i.e., because of joint and several liability arrangements between these entities) and such consolidation would not be harmful to the interests of creditors, taking into account that the consolidation would save the costs of making a distinction between the asset and debt position of the individual entities. On the basis of the Netherlands Supreme Court dated 25 September 1987 (HR 25 September 1987, NJ 1988, 136, *Van Kempen en Begeer vs. the bankruptcy trustees of Zilfa and DCW*), it can be deduced that a consolidation of the bankruptcies of various entities is allowed in the event that the assets and liabilities of such entities are intermingled to such extent that it would basically be impossible to separate these.

---

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in the Netherlands, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

---

Under Dutch law, future receivables can be assigned in advance (*bij voorbaat*) by the seller to the purchaser, provided that such receivables directly result from a legal relationship existing at that time, if it concerns an undisclosed assignment which is effected pursuant to section 3:94(3) of the Dutch Civil Code. In case of a *disclosed* assignment pursuant to section 3:94(1) of the Dutch Civil Code, also receivables which will arise out of future legal relationships may be assigned in advance, provided that the identity of the obligor is known so that the assignment can be notified. However, if such future receivables come into existence after the moment that the seller has been granted a suspension of payments or has been declared bankrupt, the assignment of such receivables cannot be invoked against the bankrupt estate (*boedel*). The receivables will then fall within the bankrupt estate of the seller.

---

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

---

As long as the relevant creditor has a claim against the debtor which is due and payable and remains unpaid, the debtor can be declared bankrupt (provided the statutory requirements for filing bankruptcy have been met). If, however, the claim is extinguished as a result of the limited recourse provision (i.e., there is a shortfall after liquidation of assets), the creditor cannot file for bankruptcy of the debtor on the basis of this claim, as this claim no longer exists. See the answer to question 7.3 below.

## 7 Special Rules

---

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in the Netherlands establishing a legal framework for securitisation transactions? If so, what are the basics?**

---

No such laws exist.

---

**7.2 Securitisation Entities. Does the Netherlands have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

---

No such laws exist. Typically, an issuer in a securitisation is incorporated as a straightforward private company with limited liability (*besloten vennootschap met beperkte aansprakelijkheid*) under Dutch law, the shares in which are held by a foundation (*stichting*) the sole purpose of which is to acquire and hold such shares. The company and its shareholder are usually managed by an independent corporate services provider. The company is made bankruptcy remote by means of, *inter alia*, a limited objects clause restricting its activities to the contemplated transaction and by

means of non-petition and limited recourse clauses included in its contracts with transaction parties. See questions 7.3 and 7.4.

**7.3 Limited-Recourse Clause. Will a court in the Netherlands give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

Generally, limited recourse provisions are valid and enforceable under Dutch law. Section 3:276 of the Dutch Civil Code even provides a legal basis for such provisions where it states that a creditor has recourse on all assets of an obligor unless provided otherwise by law or by contract.

If the contract is governed by a law other than Dutch law, a Dutch court would give effect to such contractual provision in accordance with the rules of the relevant law.

**7.4 Non-Petition Clause. Will a court in the Netherlands give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

Yes, such contractual provisions would, in principle, be valid and enforceable under Dutch law. If any of the other parties to such a contractual arrangement took legal action against the special purpose entity or commenced insolvency proceedings against it, in violation of the contractual obligation not to, the other party or parties to such contractual arrangement could initiate proceedings against the 'violinist' and claim compensation for damages, if any, suffered by them due to the special purpose entity being declared bankrupt. However, under Dutch law, any contractual restrictions imposed on a party to a contract to institute or join any other person in instituting insolvency proceedings against the special purpose vehicle will probably not result in such party becoming legally incompetent to institute or join any person in instituting such proceedings. It is, therefore, possible that a Dutch court would deal with a petition for bankruptcy (*faillissement*) in respect of the purchaser or such other person, notwithstanding that such petition has been presented in breach of a non-petition covenant. The court, when dealing with such petition, may come to the conclusion that the purchaser or such other person has ceased to pay its debts as they fall due (being the legal ground for bankruptcy in the Netherlands). A Dutch court may also deal with a petition for suspension of payments (*surseance van betaling*).

If the contract is governed by a law other than Dutch law, a Dutch court would give effect to such contractual provision in accordance with the rules of the relevant law.

**7.5 Priority of Payments "Waterfall". Will a court in the Netherlands give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

A contractual provision pursuant to which payments are distributed to parties in accordance with a priority of payments as set forth in a contract are legal, valid and binding obligations enforceable as a matter of Dutch law as between the parties that have agreed thereto.

If the contract is governed by a law other than Dutch law, a Dutch court would give effect to such contractual provision in accordance with the rules of the relevant law.

**7.6 Independent Director. Will a court in the Netherlands give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

There is no reason why such limitation on the competence of the management of the relevant entity would not be valid and enforceable against it. If such limitation is violated by the management board, the special purpose entity could hold the management personally liable for damages, if any, suffered by the special purpose entity due to the violation.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in the Netherlands, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in the Netherlands? Does the answer to the preceding question change if the purchaser does business with other sellers in the Netherlands?**

Under the Act on financial supervision (*Wet op het financieel toezicht*) (the "Financial Supervision Act"), financial service providers, including offerors and brokers of financial products such as consumer loans, mortgage loans and any form of credit, are subjected to licence requirements and continuous conduct supervision by the Netherlands Authority for the Financial Markets (*Autoriteit Financiële Markten*, the "AFM"). In addition, pursuant to the Financial Supervision Act, a person who becomes the legal owner of loan receivables and consequently services (*beheert*), or who administers (*uitvoert*) such loan receivables, would be required to have a licence as of the moment legal title was transferred to it. If the purchaser of the receivables is a licensed credit institution, it holds such a licence under the Financial Supervision Act by law. If a special purpose company or other entity acts as purchaser of such loan receivables, it will be exempt from obtaining a licence under the Financial Supervision Act if it has outsourced the servicing of the loan receivables and the administration thereof to an entity holding an appropriate licence under the Financial Supervision Act. The above licence requirements do not apply with respect to receivables that do not qualify as a financial product within the meaning of the Financial Supervision Act. The purchase, ownership, collection and/or enforcement of such receivables do not result in the purchaser becoming subject to the Financial Supervision Act or otherwise being required to qualify to do business in the Netherlands.

The above answer will not change when the purchaser does business with other sellers in the Netherlands.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

See the answer to question 8.1 above.

**8.3 Data Protection. Does the Netherlands have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

Yes, the use or dissemination of data about, or provided by, obligors may be subject to the provisions of the Dutch Data Protection Act (*Wet bescherming persoonsgegevens*). This act contains provisions with respect to the processing of personal data, 'personal data' being information on private individuals or information which can be traced back to private individuals, and 'processing' including the dissemination or transfer of such data amongst, or to, third parties. The act sets requirements on the way personal data should be collected and states that such collection is only allowed if any of the limitative grounds for assembling such information as mentioned in the Act apply. Furthermore, the Act indicates what requirements on quality need to be met, which reporting requirements exist and what rights the individuals whose information is collected may exercise towards the data collector in relation to such data collection.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of the Netherlands? Briefly, what is required?**

With a view to protecting the interests of consumers, there are certain limitations and restrictions in relation to consumer loans and underlying contracts (see also question 1.2 above). There are, for example, certain (continuing) information obligations in relation to the customer such as that the credit provider, on the request of the customer, must provide the customer with a specified overview of the outstanding balance. The rules maximising the interest to be charged by the lender may also apply. Further, the customer should be allowed to perform an advanced repayment of the loan.

The sale and assignment by the seller of the receivables resulting from consumer loans will be without prejudice to the rights and the protection afforded by Dutch law to the relevant borrowers.

In addition, the provider and broker of the consumer loan will be subject to certain licence requirements (see question 8.1 above).

**8.5 Currency Restrictions. Does the Netherlands have laws restricting the exchange of the Netherlands currency for other currencies or the making of payments in the Netherlands currency to persons outside the country?**

On 1 July 2012, the Money Transactions Offices Act (*Wet inzake de geldtransactiekantoren*) was repealed and the law regarding money transaction offices was included in the Financial Supervision Act. As of that date, everyone who, in the course of its business, performs exchange transactions qualifies as an exchange office (*wisselinstelling*). It is not allowed to perform exchange transactions without having obtained a licence from the Dutch Central Bank.

Under the External Financial Relations Act 1994 (*Wet financiële betrekkingen buitenland 1994*) and the balance of payments

reporting instructions 2003 (*Rapportagevoorschriften betalingsbalansrapportages 2003*), the Dutch Central Bank may appoint entities which have to report to the Dutch Central Bank in order to allow it to compile the national balance of payments. This means that the Dutch Central Bank makes sure that there is an accounting record of all monetary transactions between the Netherlands and other countries. In connection therewith, the Dutch Central Bank periodically collects data from groups of reporting entities selected by the Dutch Central Bank relating to, among others, cross-border transactions.

## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in the Netherlands? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

In principle, no withholding tax will be due in the Netherlands, unless the rules on hybrid debt apply. These rules, however, do not normally apply in relation to securitisation transactions.

**9.2 Seller Tax Accounting. Does the Netherlands require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

No specific accounting policy needs to be applied for tax purposes in the Netherlands.

**9.3 Stamp Duty, etc. Does the Netherlands impose stamp duty or other documentary taxes on sales of receivables?**

The Netherlands does not levy stamp duty, registration tax, transfer tax or other similar taxes on sales of receivables. However, Dutch real property transfer tax may be due if the receivables represent an interest in, or rights over, real property situated in the Netherlands. In practice, the latter does not generally apply.

**9.4 Value Added Taxes. Does the Netherlands impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

The supply of goods and services is VAT-taxed in the Netherlands if, according to the rules for the place of supply, the services are deemed to be rendered in the Netherlands and no exemption is applicable.

The transfer of receivables in the context of a securitisation transaction is VAT-exempt, as a result of which no VAT is due on the transfer. If a taxable person, who is generally entitled to deduct VAT, transfers receivables in such a transaction, the transfer should not have adverse consequences with respect to the transferor's general right to deduct VAT on costs.

Collection agent services are, in principle, taxed with VAT. However, on the basis of guidance of the State Secretary of Finance, such services may be treated as VAT-exempt insofar as the services constitute collection from non-defaulting debtors. In this respect it should be noted that credit management services are not covered by the guidance of the State Secretary of Finance and therefore are taxed with VAT.

Furthermore, the transferee may render a VAT-taxed service in case of factoring. The ECJ has ruled in the *MKG-Kraftfahrzeuge-Factoring* case, (26 June 2003, C-305/01), that an economic activity whereby an entrepreneur purchases debts, is assuming the risk of the debtor's default and in return invoices its clients in respect of commission, constitutes debt collection and factoring which is VAT-taxed. In this respect, the ECJ has ruled in the *GFKL Financial Services* case (27 October 2011, C-93/10) that a transfer of receivables for a price below their face value does not imply a factoring service from the perspective of the transferee, provided that the difference between the face value and the purchase price reflects the economic value of the receivables at the time of their transfer. Pursuant to the guidance of the State Secretary of Finance (Infobulletin 87/1974), factoring is considered as a VAT-taxable service if it concerns a continuing agreement in addition to which the entrepreneur is committed to take or all the risks of collecting the receivables. The incidental purchase of receivables does not qualify as factoring.

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

If the seller is required to pay the VAT, it is not possible to make claims against the purchaser. The seller, and not the purchaser, is the VAT-taxable person.

No stamp duty will be due.

**9.6 Doing Business. Assuming that the purchaser conducts no other business in the Netherlands, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in the Netherlands?**

Non-residents will not generally become liable to Dutch income tax or corporation tax, as the case may be, by virtue only of the purchase of receivables or the appointment of a servicer or collection agent, in respect of a securitisation transaction.



### Mariëtte van 't Westeinde

Loyens & Loeff N.V.  
Fred. Roeskestraat 100  
1076 ED Amsterdam  
The Netherlands

Tel: +31 20 578 5785  
Fax: +31 20 578 5800  
Email: [mariette.van.t.westeinde@loyensloeff.com](mailto:mariette.van.t.westeinde@loyensloeff.com)  
URL: [www.loyensloeff.com](http://www.loyensloeff.com)

Mariëtte van 't Westeinde, a partner in the Loyens & Loeff Amsterdam office, graduated from Utrecht University in 1990, where she studied business and social-economic law. Mariëtte started her law career in 1991 and has held various positions ranging from in-house company attorney to attorney-at-law. She joined Loyens & Loeff in April 2002 as a member of the Banking and Securities law practice group. Mariëtte has a broad experience in all kinds of specialised financial transactions, ranging from asset finance to public and private debt issues and asset management, but has a special focus on securitisations. In the domestic market the securitisation team of Loyens & Loeff is one of the market leaders. Mariëtte regularly publishes articles and is co-author of a book on securitisation in the Netherlands.



### Jan Bart Schober

Loyens & Loeff N.V.  
Dubai International Financial Centre  
Gate Village, Building 10, Level 2  
Dubai  
UAE

Tel: +97 14 437 2700  
Fax: +97 14 425 5673  
Email: [jan.bart.schober@loyensloeff.com](mailto:jan.bart.schober@loyensloeff.com)  
URL: [www.loyensloeff.com](http://www.loyensloeff.com)

Jan Bart Schober is a tax partner in the International Tax practice group of Loyens & Loeff. He specialises, *inter alia*, in structured finance. In particular, he focuses on securitisations, repackagings and similar financial transactions, both in the Dutch domestic market as well as cross-border. Currently, Jan Bart is based in the Dubai office. Before that, he worked in the London office of Loyens & Loeff for three years and in the Amsterdam office of Loyens & Loeff for eight years.

## LOYENS & LOEFF

Loyens & Loeff's Banking & Finance team, made up of lawyers from the Amsterdam, Brussels, Luxembourg, London, New York, Paris and Tokyo offices, renders advice on all aspects of financial transactions. The team has broad and in-depth experience and expertise in a wide variety of transaction and financing structures, including asset and project financing, lease transactions, secured and unsecured (syndicated) bank lending, structured financing and derivative transactions and securitisations. Where international transactions are concerned, the team collaborates with leading law firms in other jurisdictions. The securitisation department at Loyens & Loeff is a market leader in the Netherlands and, thanks to its close cooperation with our outstanding tax lawyers, the team is also highly regarded in the structured finance market. In 2009 Loyens & Loeff N.V. was awarded the Chambers Award for Benelux Firm of the Year for the second time.

# Nigeria

Cass Legal

Adebajo Odutola



## 1 Receivables Contracts

**1.1 Formalities.** In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

A formal receivables contract is not mandatory for the creation of an enforceable debt obligation on the parties thereto. General rules of contracts are applicable and, in this regard, an invoice (and indeed the conduct of the parties) are sufficient to create an enforceable debt obligation.

Please note, however: (i) transactions in which the underlying asset/goods are in respect of land are required to be in writing; and (ii) transaction to which the Moneylenders Law of certain municipalities (in Nigeria) apply are generally required to be in writing otherwise such contract would not be enforceable against a borrower.

**1.2 Consumer Protections.** Do Nigeria’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

The Central Bank of Nigeria (Establishment) Act 2007 empowers the Central bank of Nigeria (“CBN”) to issue Monetary Policy Rates (“MPR”). The MPR is the benchmark overnight rate at which the CBN loans money to commercial banks. The MPR indirectly affects the rate at which commercial banks make loans available to consumers. However, there is no statutory limit on interest rates.

In contrast, the moneylenders laws of the various states prescribe a limit on the interest chargeable in respect of loans granted under such laws. Under the Moneylenders Law of Lagos state (“ML”), the interest rate (simple interest) ceiling applicable to unsecured loans provided by a licensed moneylender is 48 per cent.

Generally, interest on late payment is contractually agreed between the lender and the borrower. However, the ML provides that a moneylender may charge default interest where either the principal or interest repayment is not received on the due date as agreed between the parties.

A consumer who files for bankruptcy under the Bankruptcy Act 1979 may suspend his repayment obligation until a receiving order is made by an official; receiver appointed by the court.

**1.3 Government Receivables.** Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Generally, contracts to which the government or its agency is a counterparty incorporates a non-assignment clause which precludes a seller from assigning his receivables under such contract or otherwise part with its right without the prior consent of such government agency. Furthermore, a substantial number of government agencies are statutorily protected by provisions which preclude the attachment of their property to satisfy their debts. However, a creditor may obtain a Garnishee order in respect of such debts.

Regarding the collection of receivables relating to a government agency, please note that it is the relevant laws establishing such government agency that stipulate that pre-action notices that must be delivered to the relevant government agency and in certain instances, the period within which such actions may be brought is limited to one year after the cause of action arose. An example of such provision is section 12 of the Nigerian National Petroleum Corporation Act which prescribes a period of one year to bring claims for the payment of debts due and payable.

## 2 Choice of Law - Receivables Contracts

**2.1 No Law Specified.** If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Nigeria that will determine the governing law of the contract?

In the absence of any express agreement regarding the choice of law by the parties, the main principles that will determine the governing law of such contract are: (i) the domicile of the parties (especially the obligor); (ii) the law of the place in which the contract is made; and (iii) the jurisdiction in which the contract is to be performed.

Where the matter relates to issues arising under any revenue law (such as taxation and related matters) the principle is that it is the applicable Nigerian revenue law that will govern such contract.

Where the receivables arise under a bill of exchange, section 72 of the Bills of Exchange Act makes provision for how conflict of laws will be resolved. Specifically, section 72(1)(a) provides that the validity of a bill of exchange as regards requisites in form is determined by the law of the place of issue.

Receivables arising under a mortgage relating to land will, by default, be governed by Nigerian law as the courts would not apply foreign law to a transaction relating to land.

- 2.2 Base Case.** If the seller and the obligor are both resident in Nigeria, and the transactions giving rise to the receivables and the payment of the receivables take place in Nigeria, and the seller and the obligor choose the law of Nigeria to govern the receivables contract, is there any reason why a court in Nigeria would not give effect to their choice of law?

The court would give effect to their choice of law provision.

- 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor.** If the seller is resident in Nigeria but the obligor is not, or if the obligor is resident in Nigeria but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Nigeria give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Subject to the exception mentioned in question 2.1 above, the court would generally give effect to the choice of foreign law as parties are free to choose the law which would govern their commercial relationship. Where the application of such foreign law is against public policy, such foreign law would not be applied. This is aptly captured in the dictum of Oputa J.S.C. in *Sonnar Nigeria Limited v. Partenreeder M.S. Nordwind (Owners of the Ship M.V. Nordwind) & Another* where in adopting Lord Denning, M.R.'s judgment in *The Fehmarn* (1958) 1 All E.R. 333 at 335, his Lordship held that: "The rather vital and radical question is – Can parties by their private act remove the jurisdiction vested by our Constitution in our Courts? ... I will adopt in entirety Lord Denning's reasoning above and say that as a matter of public policy our Courts should not be too eager to divest themselves of jurisdiction conferred on them by the Constitution and by other laws simply because parties in their private contracts chose a foreign forum and a foreign law. ... When it is said that parties make their own contracts and that the Courts will only give effect to their intention as expressed in and by the contract, that should generally be understood to mean and imply a contract which does not rob the Court of its jurisdiction in favour of another foreign forum." At pp. 544-545, paragraphs E-B.

The guidelines of the courts in cases decided in Nigeria are essentially an adaptation of the decision of Brandon J. in *The Eleftheria* (*supra*) (popularly known as the "Brandon Test") case.

- 2.4 CISG.** Is the United Nations Convention on the International Sale of Goods in effect in Nigeria?

No, Nigeria is not a signatory to the CISG. However, parties to a contract may choose the CISG to govern their contract and subject to any applicable limitation as mentioned in questions 2.1 and 2.3 above, the courts would give effect to the application of the CISG.

### 3 Choice of Law - Receivables Purchase Agreement

- 3.1 Base Case.** Does Nigerian law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Nigerian laws or foreign laws)?

Generally, the sale of receivables need not be governed by the same law as the receivables themselves. However, please note that there are exceptions where the receivables arise under a bill of exchange and where the receivables arise under a mortgage relating to land or debt securities. A sale of a receivable by way of an assignment of the Deed of Mortgage would necessarily be governed by Nigerian law.

- 3.2 Example 1:** If (a) the seller and the obligor are located in Nigeria, (b) the receivable is governed by the law of Nigeria, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Nigeria to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Nigeria, will a court in Nigeria recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

In the absence of fraud, misrepresentation and duress, the sale would be effective against the seller and the obligor based on the principle of *pacta sunt servanda*. With specific reference to third parties, please note that in the event of insolvency, the secured creditors of the obligor and other unsecured creditors may have priority in relation to the distribution of the assets of the seller and obligor.

- 3.3 Example 2:** Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Nigeria, will a court in Nigeria recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

The courts will recognise the sale as being effective against the seller and third parties as the location of the parties is immaterial to determining the validity of the receivables purchase contract.

- 3.4 Example 3:** If (a) the seller is located in Nigeria but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Nigeria recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Nigeria's own sale requirements?

To the extent that the underlying contract is valid and enforceable, the courts will recognise the sale as being effective without the need to comply with Nigeria's sale requirements. In the instant scenario,

the only link to Nigeria is the domicile of the seller, the performance of the contract, its governing law and the counterparties are all outside of Nigeria. Thus any action brought before a Nigerian court for the enforcement will be decided in accordance with the governing stipulated in the contract.

**3.5 Example 4: If (a) the obligor is located in Nigeria but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Nigeria recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Nigeria's own sale requirements?**

Yes. Nigerian courts will recognise the sale as valid. Foreign law is a question of fact and will, therefore, require to be proven. Note also that where the contract is to be executed and/or enforced in Nigeria, such contract must be stamped in accordance with the provisions of the Stamp Duties Act. A failure to stamp as required would make such written agreement inadmissible in court.

**3.6 Example 5: If (a) the seller is located in Nigeria (irrespective of the obligor's location), (b) the receivable is governed by the law of Nigeria, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Nigeria recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Nigeria and any third party creditor or insolvency administrator of any such obligor)?**

Nigerian law will recognise the sale. However, in the event of insolvency, Nigerian law rules governing insolvency will apply. Similarly where the sale involves the transfer of a security interest, and notice is required to be given for the purpose of third party rights, the local procedure must be complied with.

## 4 Asset Sales

**4.1 Sale Methods Generally. In Nigeria what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

Generally, Nigerian law does not insist on any method for the sale of receivables. Terms such as sale, assignment, transfer, novation etc., may be used depending on the facts and circumstances of each case and the intention of the parties.

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

The formalities for perfecting the sale of receivables would depend on the nature of the underlying contract. Generally, the receivables

of a company form a part of its book debt and where the sale of receivables includes the creation of a security interest on such book debt, the purchaser is required to register its interest at the Corporate Affairs Commission ("CAC") (companies registry) otherwise his claims would be void against the liquidator of the seller in the event that the seller becomes insolvent.

Where the receivables arise under a mortgage or a debt security (such as a debenture secured by the assets of a debtor company) and the seller does not retain control over the underlying asset used as security for a loan: (i) the sale of the receivable would be by way of an assignment of the interest of the seller to the purchaser; and (ii) with respect to a mortgage in respect of land, the purchaser would be required to stamp the assignment agreement or a power of attorney and register the same at the relevant lands registry. Please note that this process would also apply under a debenture where the assets covered by such debenture include land.

**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

The requirement for stamping under the Stamp Duties Act 1939 applies to promissory notes, mortgage loans, consumer loans and marketable debt securities.

With respect to mortgage loans, please note that mortgages of land require the prior consent of the Governor of the state in which the property is located and the registration of such mortgage at the relevant land registry. Failure to obtain consent will render such mortgage void. A mortgage/pledge of shares will require the filing of the agreement creating such mortgage at the CAC. Where the mortgage is in respect of shares in a public listed company, a notice of such mortgage must be delivered to the Central Securities Clearing System ("CSCS") in order that notice of such security interest would be placed on the shares.

Certain types of marketable debt securities, especially those issued by corporate entities, will require registration at the CAC and, if publicly traded, the CSCS.

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

The obligation to notify the obligor or to obtain the consent of the obligor would depend on the terms of the underlying contract between the seller and the obligor. With respect to the purchaser, even where the agreement does not stipulate that the purchaser must notify the obligor, it is good practice to inform the obligor of the sale of the receivables.

If the agreement does not expressly permit an assignment, the consent of the obligor would be required.

Where the agreement prohibits an assignment, the consent of the obligor must be obtained prior to the seller assigning his rights and obligations under the agreement to the third party purchaser.



The obligation to give notice is regulated by the agreement between the parties. Certain agreements state clearly that the seller may, without notice, assign its rights under the agreement. However, whether or not the agreement imposes an obligation to give notice of the assignment to the obligor, it is standard practice to give notice of an assignment to the obligor. The fact that notice has been given does not affect the defences of the obligor against payment (i.e. a refusal to pay due to the fact that the goods supplied by the seller are defective).

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

The form of notice, the process for its delivery and applicable time limits are regulated by the agreement between the seller and obligor. With respect to the delivery of notice after the commencement of insolvency proceedings, where the underlying contract is secured against the asset of the obligor (where the obligor is a company), the relevant agreements must be filed with the CAC prior to the commencement of insolvency proceedings otherwise such agreement would be void against the liquidator. Furthermore, it will negatively impact on the purchaser ranking in insolvency of the obligor. Where the underlying contract is unsecured, the purchaser would rank as an unsecured creditor and his ranking amongst such unsecured creditors would depend on the date the agreement is entered into by the seller and the obligor.

Any notice given may only cover the receivables listed in the underlying agreement. In principle it is possible to assign present and future receivables by agreement between parties.

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that “None of the [seller’s] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]” be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says “This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]” (i.e., the restriction does not refer to rights or obligations)?**

Where the restriction is to the effect that the consent of the obligor is required for a transfer or an assignment to be effective, this does not translate into a prohibition on transfer or assignment. Rather, it seeks to make a transfer or an assignment subject to prior consent of the obligor. Please note that the example given above raises further questions on when consent is required to be obtained as the word “consent” is not qualified by an adjective such as “prior”.

The agreement contains the rights and obligations of the seller. The effect would be the same as the non-assignment clause restricts the assignment of the agreement as a whole.

**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Nigeria? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Nigeria recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

The restrictions on assignment contained in an agreement are binding and enforceable in Nigeria. There are no exceptions as the courts will generally give effect to the agreement between the parties to the extent that the same is not deemed to be illegal or against public policy.

Where a seller and purchaser, in breach of the underlying agreement between the seller and obligor proceed to assign the underlying agreement, the seller would be liable to the obligor for breach of contract. With respect to the purchaser, to the extent that there is no privity of contract between him and the obligor, the obligor would not ordinarily have a course of action against him. Where the purchaser seeks to enforce the agreement between him and the seller against the obligor, he would be liable in tort.

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

The sale document must identify the receivables to be sold in a manner sufficient to identify such receivable. The receivables to be sold need not share objective characteristics.

A clause indicating that a seller is selling all his receivables may, or may not, be enforceable. The court may decide to give effect to the commercial intention of the parties. However, the rules against uncertainty in contracts may work against such clause. A commercially prudent alternative is to create a schedule of all such receivables and make the same a part of the receivables purchase agreement.

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

The courts will generally adjudicate based on the terms of the agreement between the parties. A court may enquire into the economic characteristics of a transaction where some element of fraud, duress or misrepresentation exists, or breach of a warranty or condition of the contract.

The seller may retain all of the above by agreement with the purchaser without jeopardising perfection as all that the seller will assign is the right to the receivable.

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

Yes, he can.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?**

Yes, the seller can commit to selling future receivables. Generally, such agreements do not require any special form. However, all such documents must be stamped and where it is an agreement relating to land and debt security, the requirements dealing with consent and registration must be complied with.

Yes, there is a distinction. Receivables that arise after the insolvency of the seller would be subject to the insolvency provisions of the Companies and Allied Matters Act (“CAMA”) or the Bankruptcy Act for a company and an individual respectively. Effectively, the repayment of such receivable would be subject to the priority of debt payment provision under the insolvency rules.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

Please see our comments in relation to the assignment of receivables dealing with land and marketable securities such as debentures.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

The obligor’s right to set-off is not terminated merely by his receipt of a notice of a sale. Such right may only be terminated where the obligor expressly agrees to the same.

If the obligor’s set-off rights are terminated other than as a result of an agreement between the parties, the obligor may proceed against the seller for damage caused by such termination.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Nigeria to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

It is not customary to take a back-up security interest over the seller’s ownership rights. However, the parties may agree to create such security interest in favour of the purchaser. Where a sale is deemed not to have been perfected, the seller’s primary obligation under the agreement is not extinguished. The purchaser may bring an action for specific performance of the agreement or for the recovery of the money paid under the agreement.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Nigeria, and for such security interest to be perfected?**

There must be a signed agreement between the parties. Depending on the nature of the transaction, the agreement may be by way of a deed. Where the seller is a corporate entity, it may issue debentures. The agreement must be stamped under the Stamp Duties Act. Where there is a back-up security which may be land, shares or debentures, the purchaser must comply with the provisions of the law relating to consent and registration in the case of land and registration with the CAC and, if applicable, the CSCS in the case of corporate entities.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Nigeria to grant and perfect a security interest in purchased receivables governed by the laws of Nigeria and the related security?**

Please see our comments in question 5.2 above.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Nigeria, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Nigeria or must additional steps be taken in Nigeria?**

Certain additional steps may be required to be taken in Nigeria to perfect the creation of such security interest. One, the document must be stamped in accordance with the Stamp Duties Act in order to make such document admissible in Nigeria. Two, depending on the underlying assets over which security is taken (i.e. land) registration of the purchaser’s interest in such security will be required.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

Security in, or connected to:

- i. Insurance policies must be stamped. Furthermore, notification of the creation of a security interest over the contract of insurance must be delivered to the insurance company. Such notification would customarily include an

- authorisation directing the insurance company to list the purchaser as a first loss payee and co-insured under the relevant contract of insurance.
- ii. Promissory notes must be stamped. The negotiation of the notes must be in accordance with the Bills of Exchange Act 1917.
  - iii. Mortgage loans must be stamped. If the mortgage is in respect of land, such mortgage must receive the prior consent of the Governor and must be registered at the lands registry in the state in which such land is situated. If it is a mortgage on shares, in the case of a private limited liability company, the mortgage should be filed with the CAC, in the case of a public company, the notice of the mortgage should be filed with the CSCS. Please note that security interest created over marketable securities require some form of registration with the CAC, the CSCS or the SEC.
  - iv. Consumer loans must be stamped. Where the loan is created by way of a bill of sale under the Bill of Sales Law of Lagos state such consumer loan must be registered at the bill of sales registry.

**5.6 Trusts. Does Nigeria recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Yes, trust arrangements are recognised. However, please note that secret trusts are not recognised.

**5.7 Bank Accounts. Does Nigeria recognise escrow accounts? Can security be taken over a bank account located in Nigeria? If so, what is the typical method? Would courts in Nigeria recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Nigeria?**

Yes, Escrow accounts are recognised. Security can be taken over a bank account by way of an accounts charge agreement.

To the extent that the bank account is owned by the party creating the security interest, such security shall be recognised.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

The secured party would be in control of such portion of the cash as is specified in the agreement. The agreement may also specify the maximum sum of money which may be paid out of the secured account within any applicable payment period. However, an acceleration of a facility would necessarily grant a right to the secured party to receive all the proceeds flowing into the secured account. In any event such control is limited to the period required to recover the actual amount owed and outstanding.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Yes, if the relevant security agreement provides for a debt service minimum amount and the amount in such account exceeds the debt

service minimum, the owner of the account will have access to any excess amount without negatively impacting the security.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Nigerian insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

Yes, insolvency laws will prohibit the purchaser from doing anything or taking any action in relation to the purchased receivables. This is provided for in section 417 of CAMA.

CAMA already provides for a stay of action once winding-up proceedings have commenced against a company. Please note our earlier comment to the effect that if the sale of receivables is required to be filed with the CAC and the purchaser fails to file the same, his claim would be void against the liquidator of the seller.

Where the purchaser is deemed to be a secured party (on the assumption that all registration requirements and filings have been complied with), he shall rank as a secured creditor and be entitled to payment along with other secured creditors. Please note that in the event of insolvency, CAMA provides a detailed list of the priority ranking of beneficiaries.

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

There is a statutory stay of action which applies to all creditors. However, to the extent that the liquidator assumes the powers of the directors, the liquidator may prohibit the exercise of the rights of the purchaser.

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Nigeria for (a) transactions between unrelated parties, and (b) transactions between related parties?**

CAMA provides that a transaction that would be regarded as fraudulent under the Bankruptcy Act would be regarded as fraudulent in relation to a company that is subject to insolvency proceedings. The period stated under the Bankruptcy Act is within three months from the date of the transaction to the presentation of a bankruptcy petition against such bankrupt person. If the liquidator is of the opinion that the effect of such transaction is to give preference to any party as against the other beneficiaries, such transaction shall be declared void for creating a fraudulent preference in favour of such party.

Please note that there is no distinction between related and unrelated parties.

**6.4 Substantive Consolidation.** Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

The liquidator may, where the purchaser is seen to have colluded with the seller to dissipate its assets, seek to recover all such assets from the purchaser. Where the purchase is regarded as contributory under CAMA for the purposes of winding up the seller, the liquidator will seek to recover any amount adjudged to be in the possession of the purchaser.

**6.5 Effect of Proceedings on Future Receivables.** If insolvency proceedings are commenced against the seller in Nigeria, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

Please see our comments in question 6.1.

**6.6 Effect of Limited Recourse Provisions.** If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?

Yes. The requirement of Nigerian law is that any person who is unable to pay a debt of approximately US\$12 may be declared insolvent. It may, however, be a valid defence that as against a particular creditor who has agreed to limited recourse financing, the financial exposure must be limited to available assets identified in the contract and that the balance is therefore extinguished or forfeited.

## 7 Special Rules

**7.1 Securitisation Law.** Is there a special securitisation law (and/or special provisions in other laws) in Nigeria establishing a legal framework for securitisation transactions? If so, what are the basics?

There is no special securitisation law. However, there is a securitisation bill which was submitted to the National Assembly in 2012.

The current provision of the law which deals with securitisation can be found in CAMA, the Investment and Securities Act 2007 ("ISA") and the SEC Rules made pursuant to the ISA. Others are the Stamp Duties Acts, Bankruptcy Act, Bills of Exchange Act, Moneylenders Law and the Bill of Sales Law, Mortgage and Property Law. Please note that the acts are federal legislation applicable to the whole of Nigeria and the laws are laws enacted by Lagos State. Certain other states in Nigeria maintain similar laws.

**7.2 Securitisation Entities.** Does Nigeria have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

No. However, companies that operate as fund managers, operators of unit trust schemes and custodians are required to be registered with the Securities and Exchange Commission and are regulated accordingly.

**7.3 Limited-Recourse Clause.** Will a court in Nigeria give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

Yes, it will.

**7.4 Non-Petition Clause.** Will a court in Nigeria give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Yes, it will.

**7.5 Priority of Payments "Waterfall".** Will a court in Nigeria give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Yes. Please note that such order is always subject to the provisions of Nigerian revenue laws.

**7.6 Independent Director.** Will a court in Nigeria give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Yes, but that will relate only to voluntary winding up of a company. A director cannot preclude a creditor from initiating winding up proceeding against a company.

## 8 Regulatory Issues

- 8.1 Required Authorisations, etc.** Assuming that the purchaser does no other business in Nigeria, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Nigeria? Does the answer to the preceding question change if the purchaser does business with other sellers in Nigeria?

In order to engage in the business of factoring (in Nigeria) which is defined in the Banks and Other Financial Institutions Act (“BOFIA”) as other financial institutions, such entity must be licensed by the Central Bank of Nigeria. There is no provision in BOFIA which defines the threshold of transactions which will qualify an entity to be regarded as a factor.

It is arguable that to the extent that a purchaser is not resident in Nigeria, and the debts were not acquired in Nigeria, such purchaser need not be licensed by the CBN. Practical issues which may arise will include the enforcement of any security underlying such debt. Where all that the purchaser obtained is a right to the receivable and nothing more, such purchaser need not register, as the duty to collect still lies with the seller.

No, the above applies even where the purchaser deals with other sellers.

- 8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

The seller does not require any licence in order to continue to enforce and collect receivables following a sale to a purchaser. Where the third party’s business qualifies as a factoring business, a licence will be required.

- 8.3 Data Protection. Does Nigeria have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

No, it does not.

- 8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Nigeria? Briefly, what is required?**

No, he will not.

- 8.5 Currency Restrictions. Does Nigeria have laws restricting the exchange of Nigerian currency for other currencies or the making of payments in Nigerian currency to persons outside the country?**

No. As long as all payments are made through authorised channels (i.e. banks) and valid reason adduced for such payment, there are no restrictions.

## 9 Taxation

- 9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Nigeria? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

To the extent that coupons are not attached to such receivable (i.e. the receivables is not discounted), the payment of withholding tax is not required.

Receivables which generate coupon payments will attract withholding taxes in respect of such coupon payments.

If the term to maturity of the receivable is 10 years or more with a moratorium of at least 12 months, the purchaser would enjoy a 100 per cent exemption from the payment of taxes on interest.

Where the seller or purchaser is a foreign entity, the effective withholding tax rate is 7.5 per cent.

The sale of trade receivables at a discount will result in the difference being characterised as profit accruing to the purchaser and shall be taxed accordingly.

The deferred purchase price will not be characterised as interest. Please note, however, that any positive difference in the purchase price, deferred or otherwise, and the receivable will be taxed in the hands of the purchaser as the same would be regarded as profit.

- 9.2 Seller Tax Accounting. Does Nigeria require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

The accounting system recently adopted by Nigeria is the International Financial Reporting Standard though certain entities still use the Generally Accepted Accounting Principle.

Notwithstanding the above, please note that the IFRS council may declare a company as a public interest company and require such company to immediately adopt the IFRS.

- 9.3 Stamp Duty, etc. Does Nigeria impose stamp duty or other documentary taxes on sales of receivables?**

Yes, it does.

- 9.4 Value Added Taxes. Does Nigeria impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

Yes. Furthermore, Lagos state recently introduced a consumption tax at the rate of 5 per cent and sales tax at the rate of 5 per cent which are applicable to Lagos state.

- 9.5 Purchaser Liability.** If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

Generally, it is against the party liable to make such payment that the taxing authorities would make their claim. Where the burden of making such payment is on the seller, the authorities would make their claim against the seller, although they are empowered to trace such property where they intend to distrain the seller especially where the transaction is deemed fraudulent.

- 9.6 Doing Business.** Assuming that the purchaser conducts no other business in Nigeria, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Nigeria?

Tax is imposed on profits brought into, accruing in, derived from, or received in, Nigeria. To the extent that the proceeds of the receivables are collected in Nigeria and it maintains the seller as its agent, the purchaser shall be liable to tax in Nigeria, it would be deemed to maintain a permanent place of establishment in Nigeria.



**Adebajo Odutola**

Cass Legal  
319, Borno Way  
Off Herbert Macaulay Way  
Yaba, Lagos state  
Nigeria

Tel: +234 803 785 6033  
Email: [aodutola@casslegal.com](mailto:aodutola@casslegal.com)  
URL: [www.casslegal.com](http://www.casslegal.com)

Adebajo Odutola is a partner at Cass Legal and heads the Tax and Finance and the Energy practice units. Adebajo holds a masters degree in Corporate and Commercial Law from Queen Mary, University of London and has worked extensively on several project finance deals especially within the oil and gas sector. Adebajo also has extensive experience working on mergers and acquisitions, tax advisory, corporate restructuring and insolvency. Furthermore, Adebajo routinely advises international companies wishing to set up business in Nigeria and provides ongoing support to clients operating within the non-oil mining industry.



Though a relatively recent start-up, Cass Legal ("Cass") is a full service integrated law firm positioned and structured to provide a complete range of legal services to its clients. Cass is managed by seasoned legal professionals who have all previously worked extensively with the larger law firms in Nigeria. The partners at Cass have developed considerable legal expertise and accumulated a wealth of knowledge relating to various sectors of the Nigerian economy and particularly, in the non-oil mining industry, energy and natural resources law and project finance law.

Furthermore, as a result of our strong client base comprising local and international businesses, international corporations and local government organisations, we have routinely provided services on complex, single/multi-jurisdictional transactions.

Cass comprises four practice units covering the spectrum of the law, being specifically, Tax and Finance, Energy, Commercial Practice, Maritime and International Trade, and Litigation and Dispute Resolution.

# Norway

Tore Mydske



Kristoffer Hegdahl



## Advokatfirmaet Thommessen AS

### 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

(a) There are no requirements to the form of a debt obligation except in certain special areas of contract law such as consumer credit agreements, enforceable promissory notes, letters of credits and cheques, etc.

(b) An invoice will normally suffice to create an enforceable debt obligation and ordinary invoices will normally be the only evidence of a trade receivable, but standard trading terms may be, and often are, enclosed with invoices. If the creditor only issues invoices there is, of course, the risk that the buyer contests the invoice, in which case a seller may have to show evidence as to what has been delivered to the buyer in order to enforce the payment of the invoice.

(c) An oral promise to pay, or acceptance of an obligation to pay will create an enforceable obligation to pay, and obligations may likewise be created by the behaviour and customary actions of the parties. Needless to say, oral agreements or agreements based on behaviour or customary relationship between the parties can be difficult to prove in a dispute on whether an obligation to pay has been created or not.

**1.2 Consumer Protections. Do Norway’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

(a) No, except for usury provisions in the Norwegian Penal Code, there are no laws fixing a maximum interest rate.

(b) The Norwegian Act on Overdue Payments provides creditors with a statutory right to demand default interest on late payments. The late payment interest rate is set semi-annually and is currently at 9.50 per cent. The rate shall be set at the Norwegian Central Bank’s lending rate plus a margin of at least 7 per cent.

(c) A consumer obligor can turn away or terminate the credit agreement within 14 calendar days from the date of the agreement from the date the consumer received the prescribed credit information about the terms of the credit.

(d) Chapter 3 of the Financial Contract Act and regulations issued by virtue of the Act contain detailed regulations of consumer credits. Of noteworthy rights, we mention that the consumer obligor must consent to the transfer of a loan to another entity than a finance institution (typically it must consent to the transfer to a SPV). Also, the credit agreement must be in writing and a consumer obligor has the same set-off rights to a transferee as the consumer had towards the originator. The credit cannot be expressed in a negotiable document as that would prevent the consumer’s set-off rights.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

There are no specific rules applicable to receivables contracts where the government or a government agency is a party. It should be noted that the government will be immune in Norway against enforcement proceedings. This immunity against enforcement actions may extend also to certain government agencies depending on the legal basis for, and the tasks of, the actual governmental agency in question.

### 2 Choice of Law - Receivables Contracts

**2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Norway that will determine the governing law of the contract?**

If no express choice of law has been made in the contract between the seller and the obligor the Norwegian international private law principle says that the governing law of the contract will be the law in the country with the closest connection to the matter. Factors that will be relevant when determining which law has the closest connection to the matter will be (i) location of the seller and the obligor, (ii) where the order is received, (iii) where payments shall be made, etc. This principle may lead to the law of the contract being at the place of the debtor/obligor if payment shall be made at the place of the debtor.

The Act on Private International Law Applicable to the Purchase of Movable Assets will apply to the purchase of movable assets that have a connection to more than one country. If the parties have not specified a choice of law the actual purchase will be subject to the laws of the country where the seller was located when the order was

received. If the seller received the order in the buyer's country, then the law of the buyer's country will apply.

**2.2 Base Case. If the seller and the obligor are both resident in Norway, and the transactions giving rise to the receivables and the payment of the receivables take place in Norway, and the seller and the obligor choose the law of Norway to govern the receivables contract, is there any reason why a court in Norway would not give effect to their choice of law?**

No, the choice of Norwegian law would be upheld by the Norwegian courts.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Norway but the obligor is not, or if the obligor is resident in Norway but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Norway give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

Yes, a court in Norway would give effect to the choice of foreign law made by the parties provided the chosen foreign law does not contravene Norwegian public policy or Norwegian mandatory laws.

**2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Norway?**

Yes, the United Nations Convention on the International Sale of Goods has been implemented into the Norwegian Purchase of Goods Act by so-called "transformation". This follows from the Norwegian Purchase of Goods Act, see section 5, and chapter XV with specific rules applicable to international purchases. The provisions in the United Nations Convention on the International Sale of Goods (as implemented in Norway) does not apply to Nordic purchases (where the seller and buyer are located in any of: Norway; Sweden; Denmark; Finland; or Iceland), and the position has been reserved with regard to the rules relevant to the formation of a purchase contract. The provisions of the conventions have been transformed into the Norwegian Act.

### 3 Choice of Law - Receivables Purchase Agreement

**3.1 Base Case. Does Norway's law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Norway's laws or foreign laws)?**

No, the parties to a contract for the sale of receivables are generally free to choose which law shall govern the sales contract. (In other words, there exists the same freedom to choose the governing law as between the seller and the obligor.)

**3.2 Example 1: If (a) the seller and the obligor are located in Norway, (b) the receivable is governed by the law of Norway, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Norway to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Norway, will a court in Norway recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?**

Yes, the sale will be recognised as effective against the creditors or insolvency administrators of the seller or the obligor, provided the sale of the receivables has been properly perfected under Norwegian law. For the sale to be perfected under Norwegian law the obligor must receive notice of the sale of receivables from the seller to the buyer.

**3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Norway, will a court in Norway recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?**

If the sale of the receivables is subject to Norwegian law but the obligor and/or the purchaser are located outside Norway, the sale will, if perfected in accordance with Norwegian law (by notice to the obligor), be effective against the seller's creditors or insolvency administrator. There is a risk that the Norwegian court may require that the foreign law perfection requirements for the sale of the receivables at the location of the obligor must be taken into account as well. Hence it is advisable to ensure that the perfection requirements that apply to the sale of receivables in the country of the seller and also in the country of the obligor are complied with. This is because there is no clear conflict of law rule in Norwegian private international law relevant to the sale of receivables.

**3.4 Example 3: If (a) the seller is located in Norway but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Norway recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Norway's own sale requirements?**

On the basis that the parties are free to choose the law to govern the sale of the receivables, and it is clear that the sale has been properly perfected under the laws of the obligor's country, we believe that it will be difficult for the creditors of the seller to contest the sale on the basis that Norwegian law perfection requirements have not been complied with. However, we would advise that Norwegian law perfection requirements for the sale also be complied with to ensure that no doubt can be raised about the sale and to ensure that the sale is effective against the seller's creditors or insolvency administrator.



**3.5 Example 4: If (a) the obligor is located in Norway but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Norway recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Norway's own sale requirements?**

We would advise that Norwegian law perfection requirements relevant to the sale of the receivable should be complied with in addition to the rules that apply in the country of the seller to avoid that the creditors or insolvency administrators of the obligor in Norway contest the sale, and to ensure that the obligor pays the purchaser.

**3.6 Example 5: If (a) the seller is located in Norway (irrespective of the obligor's location), (b) the receivable is governed by the law of Norway, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Norway recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Norway and any third party creditor or insolvency administrator of any such obligor)?**

For the sale to be effective against the creditors or an insolvency administrator of the seller or obligor located in Norway, the sale of the receivables should, even if the foreign law of the foreign purchaser is chosen for the receivables sale contract, be perfected in accordance with Norwegian law.

## 4 Asset Sales

**4.1 Sale Methods Generally. In Norway what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

The customary terminology will be either a sale, transfer or a purchase of receivables. The term "*assignment of receivables*" would normally suggest a security arrangement rather than a sale/purchase.

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

Notice to the obligor is the general perfection requirement for the sale of receivables. There are no requirements to the form of notice, who shall send/give the notice (seller or buyer) or that the notice is in writing (although verbal notice is not recommended). In addition, registration in the Norwegian Movable Asset Registry (*Løsøreregisteret*) is necessary to obtain legal protection against third party creditors (perfection) in respect of a continuous sale.

However, a perfected continuous sale agreement will, in certain cases, not be effective against a third party which, acting in good faith and without having had notice of the sale and having exercised due diligence in such respect, has been granted a perfected security interest over or has acquired an individual trade receivable covered by the continuous sale agreement.

In addition, it is recommended that the seller is deprived of control over the receivable and the income/payment of the receivable due to the fact that where the seller retains control over the receivable and the income, the arrangement risks being re-characterised as an assignment for security purposes rather than a sale.

Once notice has been received by the obligor, the notice will be effective also against subsequent good faith purchasers of the receivables.

**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

The sale of promissory notes can be noted on the promissory note itself as transferred to a new creditor. In addition, the promissory notes should be taken out of the seller's possession and kept by the buyer or a third party holding the promissory note on behalf of the buyer and thus perfected.

Mortgage loans will normally relate to real property or assets that are subject to registration in a public registry such as ships or vehicles, etc.; the additional perfection requirement, in addition to the notice of transfer, the transfer endorsed on the actual mortgage document would be the registration of the sale and the new creditor in the relevant registry, i.e. the Land Registry or the Ship Registry or other relevant registry.

It follows from the Norwegian Financial Contract Act Chapter 3 section 55 that consumer loans must be in writing but cannot take the form of a negotiable document. The perfection requirement for the sale of a consumer loan is also notice to the consumer obligor. If the credit has been given by a finance institution the loan can only be sold to another finance institution (or similar) if the consumer obligor has given the consent to the transfer to another creditor.

Marketable debt securities will be dematerialised in Norway meaning that no document will be issued in evidence of the debt, but the debt will be registered in the Norwegian paperless securities register, "VPS". Sale of dematerialised securities obtains perfection by registration in the VPS System.

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

Notice to the obligor that the receivable has been sold is a perfection requirement and must be given by either the seller, the purchaser, or both.

Consent from the obligor is not a perfection requirement (unless the actual receivable contract contains an express transfer prohibition or states that the consent from the debtor is required for a transfer to be valid). An acknowledgment of the notice of transfer from the obligor is not a perfection requirement under Norwegian law, but is in practice used as it will constitute the required evidence that the notice has reached the obligor. If no acknowledgment is provided for, the seller or buyer who give notice must ensure by other means that the notice is received at the address of the obligor by, for example, sending the notice by recorded mail.

(a) If the receivables contract is silent on the issue of assignment/sale, the rule is that the receivable can be assigned without specific consent from the obligor. The rule is based on the general principle that money claims are transferable unless specifically prohibited.

(b) If the receivables contract expressly prohibits assignment, a sale in violation of the prohibition means the seller risks liability for breach of contract to the obligor and that the transfer to the buyer will not be valid as against the obligor.

There are benefits in giving notice; once the obligor has been notified about the transfer the obligor can no longer pay the seller but must pay the buyer (or any other entity that follows from the notice itself). The obligor can only set-off counterclaims against the purchaser if the obligor has acquired the counterclaim prior to the receipt of the notice of the transfer and the counterclaim falls due for payment prior to the receivable that is subject to the transfer.

The purchaser of the receivable will not gain any better position than the seller had with regard to the receivable that has been purchased, and hence the obligor can net or set-off related counterclaims arising out of the transferred receivable.

**4.5 Notice Mechanics.** If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

As already mentioned herein, there are no requirements to the form of notice or to the service of the notice other than it must be ensured that the notice is received at the place of business of the obligor and so that the obligor has the chance of being informed about the content of the notice. The burden of proof rests with the sender of the notice, hence the comment above that the notice should be sent by recorded mail in case the obligor does not acknowledge receipt of the notice.

The notice must specify the receivable that has been sold and the legal relationship that the receivable stems from.

Notice can be given at any time but not after the insolvency of the seller as the receivable from that time, will be seen as part of the seller's insolvency estate.

**4.6 Restrictions on Assignment - General Interpretation.** Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?

Yes, both restrictions referred to above will be interpreted as prohibiting a transfer of receivables by the seller to the purchaser.

**4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Norway? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Norway recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Yes, both restrictions in question 4.6 are generally enforceable. However, if the seller nevertheless sells receivables to a purchaser, the restrictions might, under certain specific circumstances, not be enforceable against a purchaser acting in good faith in respect of such restrictions. The seller will then be liable to the obligor for breach of contract.

**4.8 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells *all* of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

There is no specific identification requirement other than for the obligor to be able to understand which receivable has been sold. The specification must be sufficient to allow for proper notice of the sale to the relevant obligors to ensure that the sale becomes effective.

**4.9 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

If the parties denominate the transaction as a sale and state that their intention is a sale, a Norwegian court would – if invoked – be able to look into the economic characteristics of the transaction. (It should be noted, however, that we are not aware of any court

decisions on the re-characterisation issue.) A sale of receivables risks being re-characterised as a security arrangement, i.e. a secured loan rather than an outright sale depending on what has been agreed between the seller and the buyer with regard to the transfer of credit risk on the obligor, interest rate risk and the control over the collection of the income from the receivables.

If the seller retains:

- (a) the credit risk that may suggest that, in fact, the arrangement is a factoring arrangement where there is going to be a subsequent settlement between the seller and buyer later, i.e. the credit risk on the obligor risk has not been transferred to the buyer, likewise if the buyer is not given the right to freely dispose over the receivables that have been transferred;
- (b) the interest rate risk, that may also be an argument in favour of a loan and in particular if coupled with the seller having the credit risk and also control over the claims collection; and
- (c) control of collections; if the seller collects the claims and the buyer has no control over the collection or the collection account, that may be used as an argument to state that the arrangement is a secured loan rather than an outright sale.

---

#### 4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

---

Yes, the seller and buyer can agree to sell and transfer existing and future claims towards a named obligor arising out of a specific legal relationship (typically a trade account) or agree to sell and transfer all trade receivables arising in the business of the seller (traditional factoring), and in case of the latter, such an arrangement must be registered in the Norwegian Movable Asset Registry. Prior to the seller's insolvency this raises no issues. If the seller becomes the subject of insolvency proceedings the insolvency administrator will have to decide whether or not to continue the perfected contract.

---

#### 4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?

---

Yes, the sale of future receivables will be treated as the continuous sale of receivables.

Under Norwegian law it is possible for a registered business (registered in Norway) to agree to sell, assign for security purposes, or pledge its existing or future claims that arise in the business as a result of the sale of goods or services (trade receivables as opposed to, for instance, tax refunds), or to sell, assign for security purposes or pledge only a part of the trade receivables. In such sales it is not required to disclose the name of the obligor and no notice to the obligors is required. The sale, assignment for security purposes or pledge will obtain perfection by registration of a factoring agreement as a charge on the seller in the Norwegian Movable Asset Registry. However, the registration of the sale/assignment or pledge will not protect the buyer against another buyer who has acquired in good faith a competing right to a receivable included in the registered sale/assignment or pledge, and who has obtained perfection based on notice given to the obligor.

A registration of a factoring arrangement will be protected against the seller's creditors or insolvency administrators and receivables

that did not exist at the insolvency of the seller, but have been transferred and registered and will not form part of the insolvency estate (as these will be paid directly to the buyer).

The use of factoring agreements and registration in the Movable Assets Registry as a perfection requirement will only work in a securitisation transaction where the receivables that are sold include all or a distinct/separated part of the seller's trade receivables.

If future claims are sold and perfected by way of notice to the obligor, such claims will not form part of the insolvency estate either, provided that the seller has no collection control over these receivables (which will have the effect that the buyer collects and the receivables will not be affected by the insolvency of the seller). If the seller has retained collection control over the receivables, any receivables collected by the seller/seller's insolvency administrator after the seller's insolvency risk forming part of the insolvency estate.

---

#### 4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

---

If related security is to be transferred concurrently with the sale of receivables (for instance insurance or guarantees), the transfer of the related security must be perfected as well by notice to the insurance company, guarantor, etc.

---

#### 4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?

---

Under Norwegian law the obligor may set-off reciprocal obligations towards the seller, provided, however, that the obligor's cross-claim was established prior to the obligor becoming aware (or if he should have become aware) of the sale of receivables. If a receivables contract does not waive set-off but the obligor's set-off rights are terminated, the seller and the purchaser will not, in general, be liable to the obligor for damages caused by such termination, if it is not caused by a breach of contract.

---

## 5 Security Issues

---

#### 5.1 Back-up Security. Is it customary in Norway to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

---

We refer to the answer given to question 4.2 above. The perfection requirement for a security interest is the same as for a sale of receivables. It is not common to take "back-up" security over the seller's ownership interest in the receivables and related security in addition to a sale and to secure the sale should the sale be deemed by a court not to have been perfected.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Norway, and for such security interest to be perfected?**

We refer to the answer given in question 4.2 above. The perfection requirement for a security interest is the same as for a sale of receivables.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Norway to grant and perfect a security interest in purchased receivables governed by the laws of Norway and the related security?**

The perfection requirement for the purchaser's posting of a security interest over the receivables that the purchaser has bought will be notice to the obligors that the receivables have been posted as security to the financing bank of the purchaser.

Please note that Norwegian law contains a prohibition on the creation of one general charge to encompass all the present and future assets of the security provider. The purchaser must, therefore, under Norwegian law, charge each and every asset that may be subject to a charge under Norwegian law separately. (Norwegian law provides for floating charges to be granted over trade receivables, see above under question 4.11, operational equipment used in the business, business vehicles and inventory.) The perfection requirements for each and every asset charged must be complied with for the charge to be validly perfected under Norwegian law.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Norway, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Norway or must additional steps be taken in Norway?**

If the receivables are governed by Norwegian law, it may be that the third party rights relevant to the receivable will be governed by Norwegian law as well and that will depend on where the receivable is deemed to be located. If the obligor is located in Norway that will, pursuant to Norwegian private international law, be an argument for holding that the receivable is located in Norway and that hence Norwegian perfection requirements must be followed as well to perfect the sale. This means that if the purchaser is located outside Norway, and the obligor is located in Norway, Norwegian perfection requirements should be followed in addition to the perfection requirements of the purchaser's country.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

To create security over an insurance policy, the seller/pledgor and purchaser/pledgee need to enter into a pledge agreement or a declaration of pledge and notice of the charge must be given to the insurer/obligor under the insurance policy.

For negotiable promissory notes, the parties need to enter into a pledge agreement covering the promissory note and the promissory note itself must be taken out of the possession of the seller/pledgor, i.e. the purchaser/pledgee takes possession or anyone holding it on behalf of the pledgee.

Security in marketable debts securities are created by a pledge agreement and registration of the security interest created in the VPS System.

**5.6 Trusts. Does Norway recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Norwegian law does not contain the English law concept of trust. Agency is a recognised concept in Norwegian law and the agency contract will have to say clearly the duties/authority of the agent. If the seller collects receivables on behalf of the purchaser it should, as a minimum, be ascertained that the collected receivables are held on a separate collection account.

**5.7 Bank Accounts. Does Norway recognise escrow accounts? Can security be taken over a bank account located in Norway? If so, what is the typical method? Would courts in Norway recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Norway?**

Yes, escrow accounts are accounts where two parties have agreed to the terms of the operation of the account and notified the bank holding the account accordingly.

Yes, security may be taken over a bank account located in Norway. The security will be perfected by giving notice of the security to the bank holding the account. It is possible to pledge bank accounts so that the seller/pledgor is given the right to use funds from the account for operational purposes, i.e., it is not required that the account is blocked.

A Norwegian court will require that the proper perfection requirements under Norwegian law are complied with for the creation of valid pledge of the bank account here. Hence if the perfection requirements under an English law are different from those under Norwegian law, the Norwegian law requirement must be followed as well.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

Yes, within any limitations that follow from the set-off rights that the bank may have against the accountholder. (For example, it follows from the Financial Contract Section 29 that the bank cannot set-off any amounts in the account except for claims due to the bank which arise out of the account agreement with the owner of the account.)

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Yes, see the answer to question 5.7.

## 6 Insolvency Laws

**6.1 Stay of Action.** If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Norway's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

If the sale has been perfected, an insolvency official cannot contest the sale and the purchaser can continue to collect the receivables as before.

If the purchaser is a secured party and the security has been properly perfected, the purchaser can enforce the rights of the secured creditor and continue to collect the claims on that basis.

There is no automatic stay of action that extends to the actions of the purchaser, only to the actions of the seller who is subject to the insolvency proceedings and to the seller's assets. A dispute may, of course, be raised as to whether a sale or a security is effective but this is for the insolvency administrator to raise as an issue or other creditors and objections can of course lead to claims for revocation of transactions undertaken prior to the insolvency.

(For security rights that can only be enforced through the enforcement authorities, the situation is that the insolvency proceedings imposes a stay of action and so that the security holder cannot enforce the security in the stay period which is six months (see the Norwegian Insolvency Act Section 17).)

**6.2 Insolvency Official's Powers.** If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?

See above under question 6.1, the insolvency official (with the consent of the majority of the creditors) can use any means available through the courts – for instance temporary injunctions to freeze the position until the legal issues are solved through the courts.

**6.3 Suspect Period (Clawback).** Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Norway for (a) transactions between unrelated parties, and (b) transactions between related parties?

A duly perfected transaction or security can be reversed if: the transaction benefits in an improper way one creditor at the detriment of other creditors; or it serves to remove the debtor's assets from serving the creditors; or it increases the debt of the debtor if the financial position of the debtor is weak or was seriously weakened by the transaction and the other party to the transaction knew (or should have known) about the debtor's financial difficulties and the circumstances that renders the transaction improper. The clawback period for this subjective rule

is 10 years and so that transactions perfected more than 10 years before the opening of the insolvency cannot be revoked by virtue of this provision.

In addition there are the objective clawback rules in respect of:

- (i) gifts completed later than a year before the opening of the insolvency can be revoked;
- (ii) extraordinary payments made by the debtor later than three months before the opening of the insolvency can be revoked if the payment is unusual and substantially results in a weakening of the debtor's financial position; and
- (iii) security for debt in existence, i.e. security posted by the insolvent debtor later than three months before the opening of the insolvency proceedings if the security is security for debt in existence before the creation of the security or if the perfection measure is not completed without delay after having incurred the debt.

This three-month period is extended to two years between related parties.

**6.4 Substantive Consolidation.** Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

In general, it is not possible for the insolvency official to consolidate the assets and liabilities of the purchaser with those of the seller or his affiliates. It cannot be out-ruled that a judge could look differently at the corporate structures where the companies and the management of the companies are interconnected, or if the corporate structures have been established to benefit only certain creditors or parties.

**6.5 Effect of Proceedings on Future Receivables.** If insolvency proceedings are commenced against the seller in Norway, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

The insolvency administrator shall assess the assets and the liabilities of the bankruptcy debtor. The insolvency administrator has to decide how to handle the bankruptcy debtor's contractual obligations; such as the continued sale of receivables that occur (or receivables that have been sold and only come into existence after the opening up of the insolvency proceedings. The insolvency administrator can choose whether to terminate or to continue the contract. If the insolvency administrator decides to continue the contract, the contract will continue on its terms.

**6.6 Effect of Limited Recourse Provisions.** If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?

No, not if the debtor's debt does not exceed the sum of its assets and revenues.

## 7 Special Rules

### 7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Norway establishing a legal framework for securitisation transactions? If so, what are the basics?

Yes. The Norwegian Financing Activity Act has, since January 2004, had a chapter V headed “*Securitisation of loan portfolios*” which enables finance institutions to transfer a fixed loan portfolio or other group of claims to a special-purpose vehicle for securitisation. The SPV will be exempt from the licensing requirements for banks.

The finance institution must, before the transfer, inform the loan obligors affected by the transfer about the entity that shall manage the loan after the transfer and of which rights and obligations the special purpose vehicle and the finance institution shall have towards the loan obligors. The loan obligors will have at least three weeks to object and if the obligor does not object that will be construed as consent in accordance with the Financial Contract Act Section 45. (This consent right cannot be waived by contract in consumer loans.)

### 7.2 Securitisation Entities. Does Norway have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Yes. The SPV cannot conduct any other business than to acquire, own and collect on the loan portfolio. The SPV must finance the acquisition of the loans by the issue of bonds. The SPV must be organised as a company limited by shares (private or public) although permission can be obtained for another corporate form (for instance an Irish limited company). The SPV cannot use the same name as the finance institution that has sold the loans and the SPV can only contract with the transferring finance institution for the management of the portfolio, or a bank or another finance institution similar to the transferor institution.

### 7.3 Limited-Recourse Clause. Will a court in Norway give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

Yes, in general the courts in Norway would give effect to such a contractual provision unless it is deemed unreasonable.

### 7.4 Non-Petition Clause. Will a court in Norway give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

At the outset, the contractual provisions will be respected unless the provision is deemed unreasonable.

### 7.5 Priority of Payments “Waterfall”. Will a court in Norway give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Yes, at the outset but subject to the provision not being unreasonable and the debtor not being the subject of a bankruptcy in Norway, in which case bankruptcy rules may override the contract provisions.

### 7.6 Independent Director. Will a court in Norway give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

The directors of a Norwegian company owe fiduciary duties to the company, the company’s creditors and the shareholders of the company and can be liable for not safeguarding these interests. To the extent the contractual provisions or organisational provisions of the company contravenes the statutory and fiduciary duties of the directors, the court may not give effect to the provisions.

## 8 Regulatory Issues

### 8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Norway, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Norway? Does the answer to the preceding question change if the purchaser does business with other sellers in Norway?

Conducting factoring business in Norway is a licensed activity under the Financing Activity Act and will, if undertaken on a regular basis in Norway, require a banking licence. To purchase, own and collect and enforce a portfolio of receivables or loans in Norway will most likely not constitute a financing activity in Norway but the structure may need to be pre-cleared with the Financial Supervision Authority in Norway. Likewise to acquire, own and collect receivables will not *per se* amount to a business activity in Norway.

### 8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Yes. The collection of mature receivables on behalf of third parties in Norway is a licensed activity that triggers the need for a collection licence under the Norwegian Debt Collection Act. A third party replacement servicer will also need a debt collection licence to collect in Norway. No collection licence is required to collect own receivables.

- 8.3 Data Protection. Does Norway have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

The Norwegian Data Protection Act applies to the possession and dissemination of personal data related to individuals and to some extent, to companies. Personal data may only be gathered for certain specific purposes and must be processed in accordance with the Data Protection Act.

- 8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Norway? Briefly, what is required?**

The Norwegian Financial Contract Act contains a number of provisions that must be observed with regard to consumer loans and which cannot be deviated from. The rules apply to credit agreements (any form of postponement of payment, or loan). There are rules on notice and, to a certain extent, consent from the obligor in case the loan is transferred, information duties when marketing the credit, information duties at the entry into a credit agreement, the lenders' duty to consider the creditworthiness of the consumer, the duty to explain the credit, and the duty to advise the consumer not to take up the credit, form and content of the credit agreement, change of conditions, interest on delayed payment, termination, the consumer's right to terminate or void the agreement within the first 14 days, mandatory pre-payment, set-off right, etc.

- 8.5 Currency Restrictions. Does Norway have laws restricting the exchange of Norway's currency for other currencies or the making of payments in Norway's currency to persons outside the country?**

No, it does not.

## 9 Taxation

- 9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Norway? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

Payments on receivables by obligors to the purchaser or the seller are not subject to Norwegian withholding taxes provided that the purchaser/seller does not have a permanent establishment in Norway with regard to the sale of the receivables, and that the "debt" is not considered as "equity" for Norwegian tax purposes in accordance with thin capitalisation rules.

- 9.2 Seller Tax Accounting. Does Norway require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

As a main rule, no specific accounting policy is required for tax purposes in the context of a securitisation. Please note that losses on loans and guarantees which are deducted as an expense in the financial statements in accordance with Norwegian accounting rules should be tax deductible.

- 9.3 Stamp Duty, etc. Does Norway impose stamp duty or other documentary taxes on sales of receivables?**

There is no stamp duty or other documentary taxes on the sale of receivables.

- 9.4 Value Added Taxes. Does Norway impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

As a general rule, sale of goods and rendering of services in Norway is subject to Norwegian Value Added Tax (VAT) at an ordinary rate of 25 per cent.

The sale/transfer of receivables is exempt from VAT in Norway.

Collection agent services are subject to VAT in Norway.

- 9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

Payment of VAT and taxes when applicable is the responsibility of the seller. Claims for unpaid direct and indirect taxes cannot be made against the purchaser of the receivables.

- 9.6 Doing Business. Assuming that the purchaser conducts no other business in Norway, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Norway?**

The purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors will not make the purchaser liable to tax in Norway provided that the purchaser does not have a permanent establishment in Norway. If the collection agent, etc., acting in its ordinary course of business, has other clients, and no authority to conclude contracts in the name of the purchaser, the purchaser should not be deemed to have a permanent establishment in Norway.



**Tore Mydske**

Advokatfirmaet Thommessen AS  
 PO Box 1484 Vika  
 NO-0116 Oslo  
 Norway

Tel: +47 2311 1111  
 Fax: +47 2311 1010  
 Email: [tmy@thommessen.no](mailto:tmy@thommessen.no)  
 URL: [www.thommessen.no](http://www.thommessen.no)

**Areas of expertise**

- Financial Services
- Insurance
- M&A and Capital Markets

**Core expertise**

- Financial Services
- Financing and Insurance
- Securities Law

**Business focus**

- Finance, Banking and Insurance



**Kristoffer Hegdahl**

Advokatfirmaet Thommessen AS  
 PO Box 1484 Vika  
 NO-0116 Oslo  
 Norway

Tel: +47 2311 1111  
 Fax: +47 2311 1010  
 Email: [keg@thommessen.no](mailto:keg@thommessen.no)  
 URL: [www.thommessen.no](http://www.thommessen.no)

**Areas of expertise**

- Banking and Finance
- Financial Services
- Insolvency

**Core expertise**

- Bank Loan
- Derivatives
- Financial Services

**Business focus**

- Finance, Banking and Insurance

THOMMESSEN

Thommessen is one of Norway's leading commercial law firms with offices in Oslo, Bergen and London. The firm has 300 highly qualified employees: 200 lawyers covering the entire area of business law. With more than 150 years in business, Thommessen has consistently acted in the largest and most complex matters seen in Norway and contributed to shaping the legal landscape.

Bringing experience and innovation together, the firm is well placed to meet the clients' need of timely and bold advice.

Thommessen is an independent law firm and has established relations with highly regarded law firms all over the world. This enables the firm to choose the law firm best suited to handle its clients' cases at all times. Thommessen places great emphasis on being a professional partner for its clients and on providing independent advice of the highest professional and ethical standard.

They have adopted their own code of conduct and strive to be a market leader also in terms of ethical standards.



# Panama



Ivette Elisa Martínez Sáenz



Ana Isabel Díaz Vallejo

Patton, Moreno & Asvat

## 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

a) Commercial contracts in general are not subject to special formalities for their validity. Whichever is the form and language of the contract, the parties shall be obligated in the manner and terms agreed upon between them. Good faith and the parties’ real intent prevail with respect to the letter of the agreement. Except for documents technologically filed, pursuant to article 1102 of the Civil Code, any commercial obligations exceeding US\$5,000 must be in writing and thus it is convenient to have the sale of goods or services evidenced in a written contract.

b) Invoices accepted by the obligor are one of the means of evidence of a commercial obligation (article 244 of the Code of Commerce) which rank below public documents, private documents and merchant’s minutes.

c) In the absence of a formal written agreement, a receivables contract may be deemed to exist as a result of historic relationships, if sufficient evidence is presented based on the general provisions of the Code of Commerce.

**1.2 Consumer Protections. Do Panama’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

a) Interest rates by banks and other financial entities are not regulated and there is no maximum legal rate. Maximum rates of interest on consumer credit, loans or other receivables applied by market agents to the general consumers may be determined by the Consumer Protection and Competition Authority, but to date such maximum rate has not been established. By means of Law No.81 of 31 December 2009 the rights of credit card holders are regulated, but no limits are imposed on rates of interest that may be charged by the credit card issuers. Law No.81 provides that the nominal interest rate may not be modified without prior notice given at least 30 calendar days in advance. The first increase cannot take place before the first year of the contract elapses.

b) The commercial statutory right that applies to interest on late payments is 10 per cent *per annum* (article 223 of the Code of Commerce) in the absence of a contractually agreed interest rate in the specific contract.

Consumer protection provisions prohibit the execution of blank documents by consumers and obligate providers to expressly state the interest rate effectively paid which may not exceed the maximum legal rate.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

As a general rule, all administrative contracts must be in writing and countersigned by the Comptroller General of the Republic and published in the Official Gazette for their validity and perfection. In addition, express authorisation by the Cabinet of Ministers and the favourable opinion of the National Economic Council may be required for governmental obligations that exceed US\$2,000,000. Pursuant to Law Decree No.7 of 2 July 1997, the issuance of bonds, promissory notes or any other State securities requires prior approval of the National Economic Council. Negotiability of government instruments is not restricted. On the other hand, credits against the government are regulated by certain provisions of the Tax Code and are deemed to be preferred credits with respect to other credits, except for credits on real property rights, salaries and indemnifications owed to workers, quotas owed to the Social Security Entity, to name a few. Under article 1072-A of the Tax Code, credits against the government accrue an interest rate (per each month or fraction) of two (2) percentage points over the market reference rate annually listed by the Superintendence of Banks. The reference rate of the market shall be fixed in attention to the rate charged by commercial banks during the preceding six (6) months in commercial banking financings.

Under our securities law (article 346 of Law Decree No.1 of 1999), the State and any autonomous, semi-autonomous and mixed capital entities may issue and place securities at a discount of their nominal value. These securities may also be repossessed pursuant to the procedure set forth in the Judicial Code, but the State and any State-owned entity shall not be obligated to replace securities that were initially issued to bearer. These entities may also issue certificated or uncertificated securities which may be deposited in clearing houses.

## 2 Choice of Law - Receivables Contracts

### 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Panama that will determine the governing law of the contract?

Pursuant to the applicable international private law provisions of Law 15 of 1928 (also known as the Bustamante Code), the situation of any credit is determined by the place in which it will be enforced and if not expressly stated, at the obligor's domicile. If judicial enforcement is to be sought in Panama, there are specific provisions in the Judicial Code that govern the attribution of jurisdiction, such as; the domicile of the legal entity that is sued, and the place of enforcement of the obligation, among other rules.

### 2.2 Base Case. If the seller and the obligor are both resident in Panama, and the transactions giving rise to the receivables and the payment of the receivables take place in Panama, and the seller and the obligor choose the law of Panama to govern the receivables contract, is there any reason why a court in Panama would not give effect to their choice of law?

No. The only exception would be the parties agreeing to settle the dispute by arbitration, in which case the court must decline competition in favour of the arbitration court.

### 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Panama but the obligor is not, or if the obligor is resident in Panama but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Panama give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Yes, the principle of freedom of contracting governs contractual obligations between the parties. Therefore, it is possible for a Panamanian counterparty to submit to the laws of another country or jurisdiction provided that such foreign law does not violate domestic public policy (choice of law). In addition, the parties may also submit to the courts or tribunals of a jurisdiction different to that of the Republic of Panama (choice of jurisdiction).

### 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Panama?

No, Panama is not a party to this convention.

## 3 Choice of Law - Receivables Purchase Agreement

### 3.1 Base Case. Does Panamanian law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Panama's laws or foreign laws)?

Under Panamanian law, the sale of receivables and the receivables

themselves may be governed by a foreign law, according to the principle of freedom of contracting. Nonetheless, enforcement in Panama would require certain formalities to be observed pursuant to Panamanian law, such as notice to the obligor of an assignment of the receivables duly acknowledged by notary public or any other authentic manner.

### 3.2 Example 1: If (a) the seller and the obligor are located in Panama, (b) the receivable is governed by the law of Panama, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Panama to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Panama, will a court in Panama recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes. If the sale of the receivable complies with the requirements of Panamanian law, a Panamanian court would recognise the sale as being effective against the parties involved in the sale. The foreign purchaser would have to seek enforcement of the receivable in Panama. Any creditors of the obligor or the seller or any insolvency administrators of the seller and the obligor pursuant to a bankruptcy filing made in Panama are subject to the priority stated for the respective credit under the receivable.

### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Panama, will a court in Panama recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

If the obligor of the receivable is not located in Panama, the foreign law requirements of the obligor's country must be taken into account. In the event there is enforcement in Panama, a Panamanian court would enforce these foreign law requirements to the extent they do not contravene public policy provisions governing the sale of the receivables.

### 3.4 Example 3: If (a) the seller is located in Panama but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Panama recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Panama own sale requirements?

If the obligor of the receivable is not located in Panama, the foreign law requirements of the obligor's country will apply to the sale. In the event there is enforcement in Panama, a Panamanian court would enforce these foreign law requirements to the extent they do not contravene public policy provisions governing the sale of the receivables. Any creditors of the obligor or the seller or any insolvency administrators of the seller and the obligor pursuant to a bankruptcy filing made in Panama are subject to the priority stated for the respective credit under the receivables.

**3.5 Example 4: If (a) the obligor is located in Panama but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Panama recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Panama own sale requirements?**

If the obligor of the receivable is located in Panama, he may agree to be subject to a foreign law. In the event there is enforcement in Panama, a Panamanian court would enforce the sale against the obligor to the extent these foreign law requirements do not contravene Panamanian public policy provisions. Any creditors of the obligor or the seller or any insolvency administrators of the seller and the obligor pursuant to a bankruptcy filing made in Panama are subject to the priority stated for the respective credit under the receivables.

**3.6 Example 5: If (a) the seller is located in Panama (irrespective of the obligor's location), (b) the receivable is governed by the law of Panama, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Panama recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Panama and any third party creditor or insolvency administrator of any such obligor)?**

The parties may agree that the purchase of the receivables be subject to a foreign law. In the event there is enforcement in Panama, a Panamanian court would enforce the sale to the extent these foreign law requirements do not contravene Panamanian public policy provisions. Any creditors of the seller or any insolvency administrators of the seller pursuant to a bankruptcy filing made in Panama are subject to the priority stated for the respective credit under the receivables.

## 4 Asset Sales

**4.1 Sale Methods Generally. In Panama what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

Under applicable Commerce Code provisions, any commercial document or title whereby its issuer recognises an obligation to pay a determined amount of money or a certain amount of fungible things, at a determined place and date, may be assigned by endorsement, if it was issued to the order of the issuer. If issued nominative or non-endorseable, general civil law provisions regarding assignment of credits would become applicable. Unless otherwise provided, the assignor of a commercial receivable is only responsible for the legitimacy of the credit and the legal capacity under which the assignment was executed. It is customary to structure it as an assignment of credits.

As an additional reference, please note that Panama has enacted Law 129 of 31 December 2013, "*which promotes access to credit and*

*modernizes the mobile collateral system through chattel mortgage and other provisions are issued*". The chattel mortgage is similar to a pledge, with the difference that in the pledge the asset is delivered to the creditor or a third party, while in the chattel mortgage, the asset remains in possession of the debtor. Law 129 widens the scope of assets that can be subject to collateral, including rights on existing and future assets, copyrights, industrial property rights, accounts receivable, inventories and other of similar nature.

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

Regular endorsement of a receivable made in good faith will convey to the assignee all rights incorporated in the document.

Regarding titles that are not issued to the bearer or endorsable, an assignment will be legally effective from the date it is notified to the obligor before two witnesses or by any other means that provides for authenticity. Should the obligor refuse to acknowledge an assignee as a new creditor and wish to oppose exceptions not resulting from the assigned receivable; he must raise action against it within the next 24 hours, a term after which the assignment will be validly executed.

Assignment of a receivable issued to a bearer is validly executed by delivery of the document and the holder of such receivable is entitled to sufficient title to claim incorporated rights.

**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

Mortgage loans may be assigned but applicable legal provisions require registration at the Public Registry. Assignment would only be deemed to be validly executed from the registration date. Local entities have successfully carried out securitisation of mortgage loans, thus complying with the requirement of registration.

Consumer loans and promissory notes may typically include contractual clauses expressly permitting assignment of credit and would, in practice, be assigned by means of a written agreement between the assignor and the assignee.

Marketable debt securities admitted for public trading would be transferred in the books of issuers through the facilities of the clearing and settlement entity acting as such in the relevant organised market. Transfer of publicly traded securities is also regulated by Decree Law 1 of 1999 (the Securities Law).

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

Applicable Code of Commerce provisions state that with regard to

titles that are not issued to the bearer (registered form) or endorsable, an assignment will be legally effective from the date it is notified to the obligor before two (2) witnesses or by any other means that provides for authenticity as to the date that it is made. This means that it has to be made known to the obligor but it is not necessary to obtain his consent to perfect the transaction. Should the obligor refuse to acknowledge the assignee as the new creditor and should he wish to oppose exceptions not resulting from the assigned receivable; the obligor must bring action against the assignee within the next 24 hours, a term after which the assignment will be validly executed.

**4.5 Notice Mechanics.** If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

General commercial law only imposes the obligation to notify the assigned obligor of the assignment at the time of execution or shortly thereafter. There is no requirement for approval or consent of the obligor. It is required that the assignment is made known to the obligor by any authentic means at a certain date. The obligor that, before being notified of the assignment, satisfies the creditor will be released from the obligation. Should the obligor refuse to acknowledge the assignee as the new creditor and wish to oppose exceptions not resulting from the assigned receivable the obligor must bring action against the assignee within the next 24 hours, a term after which the assignment will be validly executed. The notice can apply only to specific receivables or to any, and all (including future), receivables.

After insolvency proceedings against the obligor or the seller have commenced, the notice cannot be delivered since all commercial obligations are terminated from the bankruptcy declaration.

**4.6 Restrictions on Assignment - General Interpretation.** Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?

Such a clause should not be considered a prohibition of transfer of rights or obligations by the seller to purchase, but a provision agreed between the parties within the freedom of contracting that Panamanian laws allow, as stated in our answer to question 2.3. The result is the same if the restriction says: "*This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor].*"

**4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Panama? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Panama recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Yes, such restrictions are generally enforceable in Panama. If the seller nevertheless sells receivables to the purchaser in spite of the contractual restriction, the seller may be found liable to the obligor for breach of contract.

**4.8 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells *all* of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The receivables subject to the assignment must be identified, subject to general provisions of the Civil and Commerce Codes. There are no legal specifications as to the information that would be required in the assignment contract, but in practice it would at least contain the following information: debtor's name; debtor's ID number; document's number; date; and outstanding balance. There is no legal requirement that the receivables being sold share certain objective characteristics. In local practice, securitisation schemes operate with blocks of receivables sharing homogeneous profiles.

If the seller sells *all* of its receivables to the purchaser, or if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, the same comments apply.

Assignment of a receivable includes all accessory rights, such as mortgages, liens and other privileges. A seller in good faith will be liable for the existence and legitimacy of the credit at the time of sale, unless it was sold as dubious, but not of the debtor's solvency, unless it was expressly agreed otherwise, or that the insolvency was pre-existent and public. Even in these cases, the seller will only be liable for the price received, additionally reimbursing the purchaser of the expenses associated with the execution of the contract and expenses generated by the asset that was sold. A seller not acting in good faith will always be liable for payment of all expenses, plus damages caused.

**4.9 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

The Panamanian Securities Law provides that receivables and other future rights or intangibles may be assigned for the purpose of being

securitised. Said credits may be assigned even prior to the date from which the contracts are to be entered into, the securities or titles represented thereby will emerge or be granted. Future credits which are the object of the transfer must be identified or ascertainable in the transfer contract. In order to be ascertainable it will suffice that they be identified in the future by means of parameters, formulas, descriptions or other proceedings established in the assignment contract, even though they are not individualised in the latter. A contract of assignment of future receivables shall be in writing and will be enforceable against third parties from the date the transferors set their signature thereunto, or from the date it is acknowledged before a notary, or as from its protocolisation in a public deed. It may include repurchase or redemption provisions. The authentication of the signatures before a notary or the protocolisation of the transfer contract of the futures credits shall be equivalent to the delivery of the *res*, if the contrary could not be clearly ascertained from said contract. The transfer of futures credits shall be enforceable against the obligor of the credit transferred when served by written notice by whatever means. The transfer of futures credits is enforceable against the bankruptcy of the assignor from the date on which the contract is enforceable against third parties, but subject to other general provisions regarding bankruptcy.

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

The seller can agree to continuous sales of receivables prior to insolvency, but the effects of the bankruptcy declaration will apply to such agreement as to any other contractual obligation that will be terminated as of such date.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?**

Yes, in the context of the securities market it is possible; see the answer to question 4.8 above.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

If related security exists over the receivables, each of those would most likely require separate formalities in order to be concurrently transferred with the underlying credit. For instance, an insurance policy over the lives of debtors would require endorsement of the policy with the insurance company, the pledging of other assets would require acknowledgment of assignment, etc.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

If the receivables contract does not contain an express provision whereby the obligor waives its right to set-off against amounts it owes to the seller, the obligor's set-off rights would not terminate upon its receipt of notice of a sale, because the contractual relationship is still ongoing. If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, the seller or the purchaser would not be liable to the obligor for damages caused by such termination, provided that such termination was validly invoked under the contract.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Panama to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

It is not customary, but nothing would prevent the parties from entering into such an agreement.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Panama, and for such security interest to be perfected?**

There are no specific legal formalities provided for in local legislation. If the seller was to grant some kind of collateral upon sale of receivables, general legal provisions regarding the relevant contract would apply (mortgage, insurance, other liens, or charges).

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Panama to grant and perfect a security interest in purchased receivables governed by the laws of Panama and the related security?**

There are no specific legal formalities provided for in Panamanian legislation. If the purchaser wants to grant some kind of collateral, general legal provisions regarding the relevant contract would apply (mortgage, insurance, other liens or charges).

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Panama, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Panama or must additional steps be taken in Panama?**

If the issue at stake is the enforceability of such security interest, a local court would decline making any interpretation or judgment

regarding the validity of a contract construed and governed by foreign legislation.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

No different or specific provisions or formalities exist, other than general provisions applicable to the perfection of collaterals.

**5.6 Trusts. Does Panama recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Yes, trusts are regulated in Panama by means of Law No.1 of 1984. Trusts are widely used since trust companies are supervised and overseen by the Superintendence of Banks. Therefore, a trust structure whereby collections are allocated to the trust and held in property by the trustee for the benefit of the creditor is quite a standard transaction.

**5.7 Bank Accounts. Does Panama recognise escrow accounts? Can security be taken over a bank account located in Panama? If so, what is the typical method? Would courts in Panama recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Panama?**

Escrow accounts are contracts that are subject to the terms and conditions agreed to by the parties under the freedom of contracting principles. A bank account may be pledged in favour of a creditor. Escrow accounts are also common in the marketplace. Panamanian courts would apply public policy principles with regard to the execution of foreign judgments. In this regard the concept of public policy and what it comprises is subject to the criteria of the court on a case-by-case basis.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

A collateral pledge of cash deposited in a bank account is permitted under Panamanian law. The secured party shall have a lien on the amount guaranteed by the pledge until paid in full, but not necessarily on all cash flowing into the bank account, as it is unlikely that the pledgor will continue to make deposits after knowing the enforcement of the pledge.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Yes, the owner can have such access.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Panama's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

Yes, under article 1564 of the Panamanian Code of Commerce, one of the effects of the bankruptcy declaration against the obligor is that, by operation of law, the obligor is inhibited or separated from the management or disposition of its assets and of any acquired during the proceedings.

The Panamanian Code of Commerce regulates the bankruptcy of companies or natural persons engaged in business activities and its effects, but there are no specific provisions to regulate insolvency. Bankruptcy proceedings under Panamanian law aim at distributing the assets of a business among its creditors due to non-payment of one or more liquid commercial obligations. The estate of the business is bound to pay the credits that stand against it, and all creditors have a part against the common obligor.

A petition requesting the declaration of bankruptcy may be filed before a court by the obligor himself, whenever he fails to pay a commercial obligation within the next two (2) days after the obligation is due. The declaration of bankruptcy may also be requested by any creditor of the obligor. To this effect, a request for bankruptcy must be filed, together with evidence of the credit. Once the bankruptcy request is filed, the court issues an order for: the embargo and deposit of the assets, the books, and other documents of the company; the appointment of a curator for the meeting of creditors; the summons of all interested parties to the proceedings within the next ten (10) days; and the summons of the creditors to a general meeting. The general meeting of creditors gathers together every creditor who may have presented his claim within term, and has the object of establishing the amount and type of each credit. The curator must be a lawyer, and is charged with the management of the assets, including the company's books, the safekeeping and collection of credits, and the sale of all assets with the approval of either the meeting of creditors or the court. Once the credits have been evaluated and recognised by every creditor, the obligor may present the meeting of creditors with a payment plan. If the plan is accepted, the curator shall supervise its execution. If the plan is not accepted or the obligor offers no plan, the curator shall proceed to sell the assets. Once the obligor fulfils the terms of the plan of payments or the full amount of outstanding credits is paid for, a request can be filed before the court to declare his discharge in order to put an end to the effects of the bankruptcy. Once the court declares the bankruptcy, it has the following effects on the obligor, among others:

- The court must order the seizure (embargo) of any assets owned by the obligor.
- The obligor may not manage or dispose of his current assets and those acquired while the state of bankruptcy is in force.
- The credits guaranteed with pledge or mortgage may be enforced in a separate proceedings.
- Unless the credits are guaranteed with pledge or mortgage, as of the bankruptcy declaration, the interests on the bankruptcy estate cease to accrue.

- All civil and commercial debts of the obligor are enforceable as of the bankruptcy declaration with discount of the applicable interests.
- Payments and any other transfer and administration legal transactions undertaken by the obligor after the bankruptcy declaration shall be null and void.
- Any bilateral contracts that have not been totally performed or have been partially performed at the time of the bankruptcy declaration shall be terminated by operation of law. In this case, the other contracting party may only claim liquidated damages as creditor of the bankruptcy estate, except if the credit is guaranteed by a pledge or mortgage.

Finally, the granting of a mortgage or pledge or any other act or provision aimed at ensuring credits previously contracted or to give them preference upon other credits, shall also be null and void in the benefit of the mass of creditors, if such acts were carried out after the existence of a legal condition of bankruptcy under article 1545 of the Code of Commerce or in the 30 previous days.

---

#### 6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?

---

The bankruptcy's curator has the following powers and attributions:

- The curator must undertake an inventory of assets of the obligor.
- The curator is entitled to act on behalf of the obligor throughout the proceedings.
- The curator also acts on behalf of the creditors' meetings in all proceedings against the obligor in bankruptcy.
- The curator manages the assets of the obligor.
- The curator collects and receives all credits and rents and pays the obligor's expenses.
- The curator undertakes the sale of assets of the obligor.
- The curator reviews the titles of credit presented by the creditors and submits said credits to the Creditors' Meeting for their acknowledgment.
- The curator promotes the celebration of the Creditors' General Meeting.
- The curator renders accounts of its management to the Creditors' General Meeting.

---

#### 6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Panama for (a) transactions between unrelated parties, and (b) transactions between related parties?

---

In connection with fraudulent conveyance issues, under our Code of Commerce, any payments or other legal acts of transfer of title or administration carried out by the bankrupt after the bankruptcy has been declared shall be null and void without any special declaration. This also applies to any payments made to the bankrupt after the bankruptcy declaration has been published. In addition, it applies to any gratuitous acts or contracts carried out, or entered into, by the bankrupt during the four years preceding the bankruptcy declaration or its retroactive effects, in favour of the bankrupt's spouse, children, parents, brothers/sisters or in-laws.

---

#### 6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

---

Only to the extent the assets and liabilities of the seller and its affiliates are deemed to be credits of the obligor's bankruptcy estate.

---

#### 6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Panama, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

---

Since one of the effects of the bankruptcy declaration is that any bilateral contracts that have not been totally performed or have been partially performed at the time of such declaration shall be terminated by operation of the law, the sales of receivables that have not yet occurred or have not yet come into existence or that only come into existence after the commencement of such proceedings would be terminated by operation of law. In these situations, the other contracting party may only claim and liquidate damages as creditor of the bankruptcy estate, except if the credit is guaranteed by pledge or mortgage.

---

#### 6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?

---

Such provision would not be enforceable in the context of a Panamanian bankruptcy proceeding.

## 7 Special Rules

---



---

#### 7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Panama establishing a legal framework for securitisation transactions? If so, what are the basics?

---

Panamanian Securities Law entitles the Superintendence of the Securities Market to issue regulations regarding the registration, disclosure and reporting requirements of public issue of securities through securitisation schemes.

Regulations have been issued regarding registration of issuers that publicly offer securities, as well as the disclosure and periodic reporting requirements, but no specific regulation has been issued on the subject of securitisation vehicles. Article 197 of said Law expressly refers to securitisation of receivables, including securitisation of future rights (see the answer to question 4.8 above).

Therefore, a local public issue of securities made through securitisation schemes, has been registered under the regulations issued in general for the registration of securities subject to public offerings.

- 7.2 Securitisation Entities.** Does Panama have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

No laws have been passed with regard to the creation of entities or financial intermediaries specialised in structuring securitisation vehicles or engaged in the business of securitisation at their account and risk. Those who engage in the business do it under general commercial legal provisions.

- 7.3 Limited-Recourse Clause.** Will a court in Panama give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

Such provision would not be enforceable under Panamanian law.

- 7.4 Non-Petition Clause.** Will a court in Panama give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Such provision would not be enforceable under Panamanian law.

- 7.5 Priority of Payments "Waterfall".** Will a court in Panama give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Such provision would be enforceable under Panamanian law (except within the context of bankruptcy proceedings).

- 7.6 Independent Director.** Will a court in Panama give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Such provision would not be enforceable under Panamanian law. Furthermore, independent directors are not mandatory in commercial companies, only in companies subject to regulation in securities, insurance and banking activities.

## 8 Regulatory Issues

- 8.1 Required Authorisations, etc.** Assuming that the purchaser does no other business in Panama, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Panama? Does the answer to the preceding question change if the purchaser does business with other sellers in Panama?

It is our understanding that if the purchaser is not actively engaged in financial activities that are subject to public regulation and/or supervision, such as taking deposits, conducting intermediation in the securities markets or otherwise, the mere activity of acquiring and/or investing in receivables originated by other entities, would not trigger the obligation of obtaining licensing or authorisation from a public authority.

The answer would not vary if the purchaser does business with other sellers in the country.

- 8.2 Servicing.** Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Enforcement and collection of receivables in Panama by a party not doing business in Panama does not require a licence.

- 8.3 Data Protection.** Does Panama have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Law 24 of 2002 regulates the information service of credit history of consumers and it applies to both individual obligors and enterprises.

- 8.4 Consumer Protection.** If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Panama? Briefly, what is required?

Applicable consumer protection provisions would most likely be relevant at the time of origination of credit. Banking and other lending institutions would be subject to ongoing information duties with clients and fulfilment of such information duties will typically rely on the party acting as administrator of the receivables.

- 8.5 Currency Restrictions.** Does Panama have laws restricting the exchange of Panama's currency for other currencies or the making of payments in Panama's currency to persons outside the country?

At present, there are no laws or regulations restricting the exchange of currency. Payment to persons outside the country is subject to withholding taxes at a rate of 12.5 per cent if the service rendered by the foreign party to the Panamanian taxpayer affects the preservation or generation of Panamanian-source income.



## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Panama? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

Tax legality is among the fundamental rights enshrined in the Political Constitution of the Republic of Panama, which means that all taxes and revenue schemes must be enacted into law. The Tax Code (Law No.8 of 1956 plus its successive reforms) is the principal body of law governing the country's taxation system. The hallmark of Panamanian taxation is strict adherence to the principle of tax territoriality. Thus, article 694 of the Fiscal Code specifies that only "taxable income generated from any source within the territory of the Republic of Panama regardless of where it is received" is subject to income tax. Said article clearly envisions certain activities as not taxable within the Panamanian territory by not considering them to be income:

- Invoicing from a business within Panama for the sale of merchandise or products for an amount greater than that for which such items had been invoiced to a business within Panama, whenever said merchandise or products do not physically enter Panama.
- Supervise, from an office within Panama, business transactions performed, completed, or having effect abroad (offshore operations).
- Distribute dividends or shares of juridical persons, when these originate from income not produced within the territory of the Republic of Panama, including that generated by activities listed under a. and b. above.

If a natural or juridical person perceives income from both Panamanian and non-Panamanian sources, tax is liable only against that portion obtained from a Panamanian source.

Any natural or legal entity that must remit to a natural or legal entity not residing in Panama sums derived from income of any kind produced in Panamanian territory, except for dividends or participations, must deduct and withhold, at the time of remittance, the amount established in Articles 699 or 700 of the Tax Code and shall pay the withheld sums to the tax authorities within ten (10) calendar days from the date of withholding.

To calculate the withholding amount, the sums paid, drawn, credited or advanced to the taxpayer during the year must be added to the amount paid, drawn, credited or advanced and to **50 per cent of this sum** from the rate of articles 699 or 700 shall be applied. From the amount so established the withholdings already made in the taxable year shall be deducted. Currently, the withholding rate is 12.5 per cent.

By means of Law No.18 of 19 June 2006, certain provisions of the Tax Code were amended, including article 701, which establishes new rules for the application of capital gains tax derived from the sale of bonds, shares, participation quotas and other securities issued by legal persons, as well as capital gains arising from the transfer of other movable properties. Except for shares registered with the National Securities Commission and if transfer (i) is made

through a stock exchange or other organised market, or (ii) results from a merger or corporate reorganisation or consolidation and the shareholder only receives other shares in the surviving entity or its affiliate, which are exempt from capital gains tax, the following events are now subject to income tax, at a fixed rate of 10 per cent: (1) capital gains resulting from the transfer of bonds, shares, participation quotas and other securities issued by Panamanian companies; (2) capital gains derived from the transfer or sale of other movable assets; and (3) capital gains derived from the transfer of securities resulting from the acceptance of a public offer for the purchase of shares, pursuant to the Securities Law.

Income produced by capitals or securities that are economically invested in the territory of Panama, regardless of whether the sale is executed in or outside of Panama is considered Panamanian-source income and thus, taxable.

The buyer of the shares has the obligation to withhold, from the payment to the seller, 5 per cent of the total amount of the transfer, on account of income tax payable on the seller's capital gains. The buyer has the obligation to send payment to the Tax Authorities within 10 days following the date the obligation to pay arose. If there is a breach of this obligation, the issuer company is jointly liable for the payment of the unpaid tax.

The seller has the option to consider the sum withheld by the buyer (5 per cent) as the definitive income tax to pay for the capital gains. If the sum withheld exceeds the amount resulting from the application of the 10 per cent rate to the gain obtained from the sale, the seller may file a special tax return to credit the sum retained and claim the excess resulting as a credit in his favour. This credit may be assigned to other taxpayers. The sums obtained from the transfer are not cumulated to the taxpayer's taxable income.

In case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, we find that the risk that the deferred purchase price will be recharacterised in whole or in part as interest is remote.

**9.2 Seller Tax Accounting. Does Panama require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

Panama has traditionally adopted US GAAP, but regulations issued by the Internal Revenue Director now provide that the accounting standards of the International Accounting Standards Board (IASB) must be applied to companies that bill over US\$1 MM.

**9.3 Stamp Duty, etc. Does Panama impose stamp duty or other documentary taxes on sales of receivables?**

As a general principle, stamp taxes are collected via sworn statements or by any other means authorised by the Revenue Directorate General of the Ministry of Economy and Finance. The person obligated to pay this tax should submit to the Revenue Directorate General sworn statements attesting to the number of executed documents liable for tax, the total amount of the face value on them, and the amount of corresponding tax payable.

The stamp tax ranges from US\$0.01 to US\$20. The general tax provision that establishes the stamp tax indicates that the tax is US\$0.10 per US\$100 fraction of value of the document or transaction, which equals to US\$1 per US\$1,000.

This provision states that all contracts that do not have a special tax and that refer to acts that are subject to the Panamanian jurisdiction must be stamped. The general provision contains certain exceptions: documents that refer to matters that do not generate

taxable income in Panama are exempt from the stamp tax, unless the documents must be used or filed before Panamanian courts or administrative authorities, in which case, the stamp tax must be paid in order when the documents will be presented/used/filed in Panama. This means that if the contract refers to a transaction that does not generate taxable income, then the stamp tax is paid only when, and if, the document is enforced in Panama or if any registration is required.

Under our securities laws, any securities listed with the Superintendence of the Securities Market, as well as any document, contract or agreement related to their issuance, subscription, sale, payment, swap or redemption are not subject to stamp taxes.

---

**9.4 Value Added Taxes. Does Panama impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

---

A 7 per cent value added tax is levied on the transfer of movable assets in the Republic of Panama and the rendering of services by merchants, manufacturers, professionals, lessors and other service providers. The sale of receivables would not trigger the tax, since these are considered intangible rights. In addition, the transfer and negotiation of securities listed in the Superintendence of the Securities Market or that are negotiated through a stock exchange or any other organised market is exempt from capital gains taxes in Panama.

---

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

---

The withholding obligation imposed by law on the seller with respect to the value added tax of 7 per cent solves this issue. There is no express obligation either on the buyer or the seller to pay the stamp tax; generally this is agreed to in the contract, but in the absence of any provision imposing the obligation, the authorities may enforce the payment on either party.

---

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Panama, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Panama?**

---

No, it would not be considered doing business in Panama.



### Ivette Elisa Martínez Sáenz

Patton, Moreno & Asvat  
Costa del Este, Capital Plaza, 8th floor  
Panama City  
Republic of Panama

Tel: +507 306 9600  
Fax: +507 263 7887  
Email: [imartinez@pmalawyers.com](mailto:imartinez@pmalawyers.com)  
URL: [www.pmalawyers.com](http://www.pmalawyers.com)

**IVETTE ELISA MARTINEZ SAENZ**, admitted 1993, Panama.  
**Education:** University of Panama (Licentiate in Law and Political Sciences - J.D. equivalent- *Magna Cum Laude*, 1993).  
**Author:** "La Sustitución del Empleador", Graduate Thesis, University of Panama, 1993. "A Comparative Study of Panamanian and U.S. Private Interest Foundations", LL.M. Thesis, Fordham University, 1996.  
"Panama-New Private 'Anstalt'" - International Lawyers' Newsletter, September/October 1995. "The Responsibility of Bankers, Lawyers and Auditors in Merger and Acquisition Transactions", XLI Congress of the Commission of Banking Right of the Union of International Lawyers (UIA), September 1997. "Bank Credit and Consumer Protection", XLII Congress of the Banking Law Commission of the Union of International Lawyers, August 1998. Authorised Public Interpreter of the Spanish and English languages and Certified Examiner of Interpreters, (1994).  
**Memberships:** Panama Bar Association; Union of International Lawyers (UIA); Association of Fulbright Scholars of Panama; Director and Past President of the American Chamber of Commerce and Industry of Panama (AmCham), Junior Achievement Advisor (since 2002); Arbitrator appointed by the Centre of Conciliation and Arbitration of the Chamber of Commerce and Industries of Panama (since 2002); and Director of the National Concerts Association. Biography included in *Who's Who in American Law's* 13th edition (2003-2004).  
**Practice Areas:** Corporate; Commercial; and Administrative Law (Banking, Insurance, Securities, Mergers and Acquisitions, Government Contracting, Telecommunications and Energy).



### Ana Isabel Díaz Vallejo

Patton, Moreno & Asvat Group  
c/o Assets Trust & Corporate Services  
Samuel Lewis Ave., Comosa Bldg., 6th floor  
Panama City  
Republic of Panama

Tel: +507 264 2338  
Fax: +507 264 8475  
Email: [ana\\_diaz@assetstrust.com](mailto:ana_diaz@assetstrust.com)  
URL: [www.assetstrust.com](http://www.assetstrust.com)

**ANA ISABEL DÍAZ VALLEJO**, born in Panama, Republic of Panama.  
Vice-President/Legal Department of Assets Trust & Corporate Services, an affiliate of the Patton Moreno & Asvat Group. University of Panama, 1992 (Licentiate in Law and Political Sciences - J.D. equivalent). Master of Laws in Commercial Law from Externado de Colombia University, 1994. Legal counsel of the Superintendence of Banks, 1999. Director of Securities Registration (2000-2002), Director of Legal Affairs (2002-2005) and Director of Market Surveillance (2005-2006) of the National Securities Commission.



PATTON, MORENO & ASVAT  
INTERNATIONAL LAWYERS

*Patton, Moreno & Asvat* is celebrating 33 years of experience in providing legal services to both local and international clients.

With an ongoing vision to develop new businesses and to offer integrated legal counseling oriented to the establishment, promotion and development of international business relationships, three young entrepreneurs decided, in 1981, to establish an efficient and modern law firm in the Republic of Panama. This is how the founding partners joined their efforts to accomplish their common goals, which in turn gave birth to the successful reputation that the firm maintains not only in Panama, but in other countries where the firm has an important presence.

The *Patton, Moreno & Asvat* Group is comprised of 21 attorneys and close to 150 employees worldwide. Our staff of lawyers has successfully achieved graduate, post graduate, master's and doctorate degrees in well-recognised universities such as Duke University, Tulane University, Harvard University, Boston University, University of Pennsylvania, Cardiff University and Fordham University, among others.

The firm strongly believes in the constant update and international projection of its lawyers and personnel, promoting their participation in local and international conferences and seminars.

Our lawyers have also participated in the drafting of laws, thus contributing with the legislative work of our country.

*Patton, Moreno & Asvat's* areas of practice include: Corporate; Maritime; Contracts and Commercial Transactions; Real Estate; Public Procurement; Telecommunications; Energy; M&A; Intellectual Property; Banking Law; and Aeronautical Law, among others.

Our affiliates include: **ACE Funds Services Inc.**, based in the British Virgin Islands, engaged in investment funds advisory services; **Assets Trust & Corporate Services**, which provides local and offshore fiduciary services, tax planning and structuring and back-office services; **HPA Lawyers**, our own law firm in the BVI; and **Xperta Corporate Limited Services**, our incorporation services company for the European market.

# Portugal



Paula Gomes Freire



Benedita Aires

Vieira de Almeida & Associados –  
Sociedade de Advogados, R.L.

## 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

The legal requirements applicable to the form of a contract between a seller and an obligor depend to a large extent on the nature of the contract (if it is a loan agreement made by a bank to a customer, an agreement between a utility company and a customer, etc.). As an example, the general rule applicable to the granting of credit facilities to consumers is that the relevant contract has to be in writing.

The general civil law principle, however, (i.e. the rule which applies by default whenever there is no specific rule applicable to a certain type of contractual relationship), is that there is no generally prescribed applicable formality for contracts to be entered into, and therefore a valid contractual relationship for the sale of goods and services can even be established orally (unless otherwise stated in a specific legal provision), and in those circumstances the existence of an invoice is naturally also sufficient to document the relevant contract.

In order for a receivables contract to be deemed to exist as a result of the parties’ behaviour alone, it has to be possible to conclude, based solely on the parties’ actions, that their intention was to enter into a contract. In other words, the parties’ behaviour has to be, for all purposes, equivalent to a contractual statement.

**1.2 Consumer Protections. Do the laws of Portugal: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

(a) As a general rule, the Portuguese Civil Code foresees a legal interest rate. This rate is currently set at 4 per cent. Any stipulation of an interest rate superior to the legal rate must be made in writing. Also, stipulated rates may not exceed the legal interest rate by more than 3 per cent (if the obligation is secured) and by more than 5 per cent (if it is not). Interest stipulated over these limits is deemed reduced to the aforementioned maximum rates.

The general rules described in the previous paragraphs do not apply to credit institutions. However, in accordance with the Portuguese legal framework for consumer credit (Decree-Law no. 133/2009 of 2 June 2009 (as amended and currently in force), implementing Directive 2008/48/CE on consumer credit agreements), the Annual Percentage Rate of Charge charged by credit institutions to consumers (including in relation to leasing transactions) is limited to a three-month average disclosed by the Bank of Portugal plus one-third of that average. For the first trimester of 2014, this means that the maximum Annual Percentage Rate of Charge for consumer credit is (i) 17.2 per cent, for personal loans (other than loans for specific purposes such as health or education, or financial leases of equipment), (ii) 23.1 per cent, for credit cards, credit lines, current accounts or overdraft facilities, and (iii) between 8.0 and 15.3 per cent for automobile loans (depending on whether the vehicle is new or used). An amendment to Decree-Law no. 133/2009 came into force on 1 July 2013 limiting the maximum Annual Percentage Rate of Charge for consumer credit regarding (i) personal loans (other than loans for specific purposes such as health or education, or financial leases of equipment) to 19.5 per cent, and (ii) credit cards, credit lines, current accounts or overdraft facilities to 27.5 per cent.

(b) As a general rule, the Portuguese Civil Code applies delay interest. As per (a) above, the legal delay interest rate is set at 4 per cent, except if the remuneratory interest (i.e. interest charged under (a) above) is higher, or if the parties agree on a higher delay interest rate. Similar to (a) above, stipulated delay interest rates may not exceed the legal delay interest rate by more than 7 per cent (if the obligation is secured) or by more than 9 per cent (if it is not). Delay interest stipulated over these limits is deemed to be reduced accordingly.

However, under the Portuguese Commercial Code and Ministerial Order no. 277/2013 of 26 August 2013, where the creditor is a commercial company (which may be a legal or a natural person, for instance an individual merchant acting as such) a special delay interest rate applies. At the moment, this rate is set at 7.25 per cent. The limitations to stipulated delay interest rates mentioned in the previous paragraphs also apply, with the legal rate being 7.75, instead of 4, per cent. Also, under the new framework for the payment delays in commercial transactions, approved by Decree-Law no. 62/2013 of 10 May 2013, and Ministerial Order no. 277/2013 of 26 August 2013, all payments made as remuneration of commercial transactions are subject to a special delay interest rate which is currently set at 8.25 per cent.

With regard to credit institutions, there is a new special framework (revoking Decree-Law no. 344/78 dated 17 November 1978) approved by Decree-Law no. 58/2013 of 8 May 2013, which also limits the delay interest rate which may be charged. In accordance

with this special framework, credit institutions may stipulate delay interest rates of up to 3 per cent over the rate applicable to the transaction, which covers principal overdue and not yet paid.

(c) There is, in most circumstances, an unconditional right to terminate the receivables contract during the initial 14 days after execution, in which case the advanced amount is given back to the lender and the contractual relationship terminates, but the financial institution may not charge any additional fees with regard to the termination.

(d) Under the Portuguese consumer credit legal framework, financial institutions may only carry out the acceleration of defaulted loans (or terminate the relevant agreement) when more than two instalments (totalling more than 10 per cent of the entire amount outstanding) are due and only following notification to the debtor to that effect, granting him at least 15 days to pay the amounts due and expressly warning him of the possibility of accelerating the loan. Other rights mostly relate to information and contents obligations, the right to render the contract void or voidable if information is not provided, etc.

### 1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Public procurement rules may apply. If the government is acting under private law, it should not have special prerogatives. In any case, specific rules may apply in relation to issues such as the validity of a delegation of powers.

## 2 Choice of Law - Receivables Contracts

### 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Portugal that will determine the governing law of the contract?

If the parties fail to specify the law chosen to govern the receivables contract, it should first be considered whether EC Regulation no. 593/2008 (“**Rome I Regulation**”) or the Rome Convention on the law applicable to contractual obligations (“**Rome Convention**”) apply to the relevant conflict.

If the Rome I Regulation or the Rome Convention apply, then Article 4 and, to the extent applicable, Articles 5 to 7 of the Rome I Regulation shall determine the governing law.

If neither the Rome I Regulation nor the Rome Convention apply, the main principles of Portuguese law in relation to the governing law of contracts determine that contracts are governed by the law which the parties considered when executing the contract (even if they have not expressly stated it), or, if this is impossible to determine (i.e. the parties’ behaviour is not conclusive in this respect), the law applicable in the place where the parties have their domicile (or, if the parties are domiciled in different jurisdictions, the law of the place where the contract was entered into).

### 2.2 Base Case. If the seller and the obligor are both resident in Portugal, and the transactions giving rise to the receivables and the payment of the receivables take place in Portugal, and the seller and the obligor choose the law of Portugal to govern the receivables contract, is there any reason why a court in Portugal would not give effect to their choice of law?

If all of the relevant aspects of the receivables contract have a connection with Portugal, there is no reason why a Portuguese court

would not give effect to the parties’ choice of Portuguese law as the law governing the contract. Please note, however, that there may be mandatory provisions of law in other jurisdictions requiring certain aspects of a contract to be governed by such law (for instance, if the transaction at stake pertains to, or is secured by, real estate property located in another jurisdiction).

### 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Portugal but the obligor is not, or if the obligor is resident in Portugal but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Portugal give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

If the Rome I Regulation or the Rome Convention apply, then Article 3 of the Rome I Regulation and Article 3 of the Rome Convention would allow the parties to choose a governing law. This choice would be subject to the limitations set out in the Rome I Regulation. Of these limitations, we believe those applicable to consumer contracts are probably those which would be more likely to apply in the context of a receivables contract, i.e. if the obligor is a consumer. Limitations in relation to public policy and mandatory principles of law also apply, but they would be less typical.

If the Rome I Regulation or the Rome Convention do not apply, the general principle in Portugal is that the parties may elect the governing law applicable. However, there are certain circumstances in which the parties are not entirely free to choose the law applicable to the whole, or part, of the contract. The parties may not choose foreign law with the intent of fraudulently avoiding Portuguese law. Furthermore, the choice of foreign law may not offend Portuguese international public policy.

Also, regardless of the applicability of the Rome I Regulation or the Rome Convention, if the obligor is resident in Portugal and to the extent that the receivables agreement could be deemed to include general contractual clauses (i.e. those which the obligor may only accept without prior individual negotiation), the choice of foreign law is likely not to preclude the full application of the provisions of Portuguese law on general contractual clauses.

### 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Portugal?

As of 23 March 2012, the United Nations Convention on the International Sale of Goods is not in effect in Portugal.

## 3 Choice of Law - Receivables Purchase Agreement

### 3.1 Base Case. Does the law of Portugal generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Portuguese laws or foreign laws)?

Portuguese law does not generally require that an assignment of receivables is governed by the same law which governs the assigned receivables. However, our experience (and that of the Portuguese authorities) is that assignment agreements for

Portuguese-originated receivables have usually been governed by Portuguese law.

In any case, given Article 14 of the Rome I Regulation (and, when the Rome I Regulation does not apply, the risk that a Portuguese court would attempt to enforce a solution similar to that which is set out therein), the parties to an assignment of Portuguese-originated receivables should comply with the obligor notification procedures set out in the Portuguese Civil Code (to the extent not covered by the exemption of notification procedures set out in the Securitisation Law).

---

**3.2 Example 1: If (a) the seller and the obligor are located in Portugal, (b) the receivable is governed by the law of Portugal, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Portugal to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Portugal, will a court in Portugal recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?**

---

We see no reason for a Portuguese court not to recognise the effectiveness of the assignment in this scenario, be it against the seller or against the obligor. The same may be said with regard to effectiveness towards the relevant third parties.

---

**3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Portugal, will a court in Portugal recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?**

---

From a Portuguese law perspective, we understand that the fact that the obligor or the purchaser are located outside Portugal would not cause a Portuguese court to decide differently from Example 1. However any mandatory foreign law requirements would need to be complied with.

---

**3.4 Example 3: If (a) the seller is located in Portugal but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Portugal recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Portugal's own sale requirements?**

---

In this scenario, if the assignment is valid under its governing law, we believe that a Portuguese court would recognise the sale as effective against the seller and any relevant third parties.

**3.5 Example 4: If (a) the obligor is located in Portugal but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Portugal recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Portugal's own sale requirements?**

---

In this scenario, we also believe that a Portuguese court would recognise the sale as being effective, subject to the considerations made in the next few paragraphs.

If the obligor is a consumer and either the Rome I Regulation or Rome Convention apply, the choice of the seller's country to govern the receivables agreement may not deprive the obligor of the protection granted by mandatory provisions of Portuguese law. We understand that the debtor notification requirements of the Portuguese Civil Code (when not waived by the application of the Securitisation Law) are mandatory provisions protecting the debtor and that, as such, the level of debtor protection enshrined in them must be met either by directly applying Portuguese law or provisions of the law of the seller's country which provide the same level of protection.

If the obligor is a consumer and the Rome I Regulation and Rome Convention do not apply, we still believe that the reasoning of the previous paragraph should apply, as we understand that there would be a risk that a Portuguese court attempted to enforce a similar solution.

If the obligor is not a consumer, the assignment may be deemed valid if the obligor notification procedures mandated by the law governing the receivables agreement are followed.

In any case and from a risk mitigating perspective, we would recommend that all assignments of receivables owed by Portuguese resident entities be notified to the debtor in writing.

---

**3.6 Example 5: If (a) the seller is located in Portugal (irrespective of the obligor's location), (b) the receivable is governed by the law of Portugal, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Portugal recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Portugal and any third party creditor or insolvency administrator of any such obligor)?**

---

If either the Rome I Regulation or Rome Convention apply, we believe that Portuguese courts would, under Articles 3 and 14 of the Rome I Regulation, recognise the choice of foreign law regarding the sale of the assets and would, as such, have no reason not to deem the sale effective against the seller. The same result would be achieved if neither the Rome I Regulation nor Rome Convention applied, in this case through the application of the general principle of the Portuguese Civil Code under which the parties are free to elect a governing law.

As for effectiveness against the obligor, if the receivable is governed by Portuguese law then the obligor is entitled to the protection granted to debtors by the mandatory provisions of

Portuguese law applicable to assignments of receivables. As such, we would recommend that the debtor notification requirements of the Portuguese Civil Code (when not waived by the application of the Securitisation Law) are met in relation to the obligor.

## 4 Asset Sales

### 4.1 Sale Methods Generally. In Portugal what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

In the context of securitisation, the customary method for a seller to sell receivables to a purchaser is under the framework of the Securitisation Law, approved by Decree-Law no. 453/99 of 5 November 1999, as amended from time to time (the “**Securitisation Law**”). The Securitisation Law has implemented a specific securitisation legal framework in Portugal, which contains a simplified process for the assignment of credits for securitisation purposes. In fact, the sale of credits for securitisation is effected by way of assignment of credits, such being the customary terminology, consisting in a true sale of receivables under the Securitisation Law as the purchaser is the new legal owner of the receivables. It corresponds to a perfected sale of receivables, however, please note the specifics relating to exercise of set-off against the securitisation vehicle below.

### 4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

There are no specific formality requirements for an assignment of credits under the Securitisation Law. A written private agreement between the parties is sufficient for a valid assignment to occur (including an assignment of loans with underlying mortgages or other guarantees subject to registration under Portuguese law). Transfer by means of a notarial deed is not required. In the case of an assignment of mortgage loans, the signatures to the assignment contract must be certified by a notary public, lawyer or the company secretary of each party under the terms of the Securitisation Law, such certification being required for the registration of the assignment at the relevant Portuguese Real Estate Registry Office.

Additionally, the assignment of any security over real estate, or of an asset subject to registration, in Portugal is only effective against third parties acting in good faith further to registration of such assignment with the competent registry by, or on behalf of, the assignee. The assignee is entitled under the Securitisation Law to effect such registration.

In accordance with Article 6 of the Securitisation Law, the assignment of the relevant assets becomes immediately valid and effective between the parties upon the execution of the relevant assignment agreement, irrespective of the debtor’s consent, notification or awareness, when the assignor is, *inter alia*, a credit institution or a financial company.

When such is not the case, and in relation to the effectiveness of the assignment as far as the relevant debtors are concerned, the general rule is that a notification is required for the assignment to become effective, following the general principle under Article 583 of the Portuguese Civil Code.

In what concerns securitisation transactions, we should also refer that the Portuguese Securities Market Commission (the “**CMVM**”) also grants an approval to the sale and allocates a 20-digit asset-code to the bulk of receivables which constitute the asset portfolio being securitised. Please refer to our answer to question 7.2 below.

### 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

As mentioned in the answer to question 4.2 above, in order to perfect an assignment of mortgage loans and ancillary mortgage rights which are capable of registration at a public registry against third parties, the assignment must be followed by the corresponding registration of the transfer of such mortgage loans and ancillary mortgage rights in the relevant Real Estate Registry Office.

The Portuguese real estate registration provisions allow for the registration of the assignment of any mortgage loan at any Portuguese Real Estate Registry Office, even if the said Portuguese Real Estate Registry Office is not the office where such mortgage loan is registered. The registration of the transfer of the mortgage loans requires the payment of a fee for each such mortgage loan.

In what concerns promissory notes (“*livranças*”), the usual practice is for these to be blank promissory notes in relation to which the originator has obtained from a borrower a completion pact (“*pacto de preenchimento*”) which grants the originator the power to complete the promissory note. In order to perfect the assignment of such promissory notes to the assignee, the assignor will have to endorse and deliver these instruments to the assignee.

The assignment of marketable debt instruments is perfected by the update of the corresponding registration entries in the relevant securities accounts, in accordance with the Portuguese Securities Code.

### 4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

In what concerns obligor notification or consent and if the relevant receivables contract is silent in this respect, please refer to the answer to question 4.2 above. On the contrary, if the relevant receivables contract expressly requires the consent or notification of the obligors, then such consent or notice is required in order for the assignment to be effective against such obligors.

In terms of means of defence, any set-off rights or other means of defences exercisable by the obligors against the assignee are crystallised or cut-off on the relevant date the assignment becomes effective, (i) regardless of notification when such notice is dispensed as in the answer to question 4.2 above, or (ii) upon notification or awareness of the debtor when such is required.

**4.5 Notice Mechanics.** If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

Under the Securitisation Law, when applicable, notification to the debtor is required to be made by means of a registered letter (to be sent to the debtor's address included in the relevant receivables contract) and such notification will be deemed to have occurred on the third business day following the date of posting of the registered letter.

An exception to this requirement applies when the assignment of credits is made under the Securitisation Law as described in the answer to question 4.2 above.

There is no applicable time limit to the delivery of notice to the obligors, taking into account in any case that, if no exception applies, the assignment shall only be effective towards the obligors upon delivery of the relevant notice. The notice can be delivered after commencement of any insolvency proceedings against the obligor or against the seller, and the contractual documents for securitisation transactions usually include provisions to allow the assignee to be able to notify all the obligors in case the seller/assignor does not do so.

When required, notice of assignment of credits must be given to each obligor, even though notice may be given for future credits.

**4.6 Restrictions on Assignment - General Interpretation.** Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?

In the first example, we are addressing an assignment of receivables and such assignment is dependent on obtaining the obligor's consent. Unless the consent of the obligor is obtained, the receivables are not eligible for securitisation purposes under Portuguese law, given that Article 4/1/a) of the Securitisation Law establishes that receivables subject to restrictions on the transferability or assignment are not eligible for securitisation purposes. This is so due to the true sale nature of the assignment of receivables under the Securitisation Law. If such obligor's consent is not obtained, this means that the receivables contracts governing the receivables to be assigned cannot include such receivables or subject them to restrictive provisions as to their ownership transferability. Please refer to our answer to question 4.9 below.

On the other hand, the wording of the second example, addresses a situation of assignment of contractual position (in accordance with Article 424 of the Portuguese Civil Code) and not merely an assignment of credits arising thereunder. The assignment of a contractual position requires the consent of the other counterparty, and if such consent has been given prior to the assignment, it requires notification thereof to the counterparty.

**4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Portugal? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Portugal recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Restrictions on assignment existing in the underlying receivables contracts, including the restrictions mentioned in the answer to question 4.6 above, are enforceable in Portugal. However, in relation to any contractual prohibitions for assignment of credits, these can only be effective towards the assignee if it were aware of such prohibition on the assignment date, as set out in Article 577 of the Portuguese Civil Code. If a given receivables contract comprises such a contractual prohibition on assignment and nevertheless the seller assigns the receivables to a third party, then the seller will be liable towards the obligor for breach of contract, i.e., wilful default ("*incumprimento culposo*") of an obligation, in accordance with the provisions of the Portuguese Civil Code.

**4.8 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells *all* of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The assignment agreement must identify, specifically, the receivables which are being assigned under a given contract, given that the object of the assignment must be determinable in accordance with the Portuguese Civil Code, such usually being done by listing the relevant receivables in a schedule to the assignment agreement. Such list of assigned receivables refers to standard characteristics of the relevant credits, without disclosing personal data of the obligors which would allow their identification, in accordance with the applicable data protection rules. Under the Securitisation Law, bulk assignments are not considered and the seller will not assign all of its undetermined receivables to a given purchaser (or all of its receivables other than a few identified receivables), rather identifying those receivables to be actually assigned and which comply with the Securitisation Law eligibility criteria.

**4.9 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

The assignment of the receivables under a receivables sale agreement is generally construed to constitute a valid and true assignment of receivables from an originator to the assignee.



In terms of economic characteristics of an assignment of receivables, we note that the Securitisation Law requires a true and complete assignment, not being subject to any term or condition. Furthermore, neither the originating entity, nor any of its group companies, may provide any guarantees or enhancement in the context of the assignment or undertake responsibility for payments made by the underlying obligors. As such, the seller retaining credit risk, interest rate risk or control of collections (for its own benefit) or a right of repurchase could be seen as colliding with such true sale concept. In what concerns the control of collections, we would note additionally, that where the seller is a credit institution in the context of a securitisation, usually the purchaser mandates such seller to act as collection account bank and servicer of the receivables and ensure receipt of collections from the borrowers on behalf of the purchaser, it being clear however that any amounts so held by the servicer do not pertain to the servicer (even in a servicer event) and rather belong to the purchaser, in accordance with the Securitisation Law. In this sense, an assignment under the Securitisation Law will typically be a perfected assignment. In terms of repurchase, we would note that the seller would typically have an obligation under the Securitisation Law of repurchase in case of hidden defects or false representations and warranties relating to the assets.

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

Without prejudice to the answer to question 4.11 below regarding future receivables, continuous sales would be possible under the Securitisation Law provided they are in compliance with the answer to question 4.7 above. However, sellers have rather opted to carry out securitisation transactions with revolving periods for assignment of additional receivables on a periodic basis, against payment out of collections and additional funding by issuance of further notes, rather than continuous sales.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?**

Pursuant to Article 4.3 of the Securitisation Law, future receivables may be assigned for securitisation purposes provided such receivables (i) arise from existing relationships, and (ii) are quantifiable (a confirmation of the estimations made by the originator in respect of the quantum of the future receivables that are being securitised usually being sought). In terms of structure, the originator will assign to the purchaser certain rights over the future receivables, in an amount equivalent to a given overcollateralised percentage of the debt service and the originator will guarantee that the future receivables generated during each collection period will be sufficient to cover the agreed debt service and, accordingly, for each interest period it will transfer to the purchaser an amount equivalent to 100 per cent of the debt service in respect of such interest period. Furthermore, in case the originator is unable to originate sufficient future receivables to meet its obligations for a given interest period, it will, in any event, pay to the purchaser an amount equal to such shortfall of future

receivables, in order to ensure an amount equal to 100 per cent of the relevant debt service.

In respect of insolvency, we refer to our answer to question 6.5 below.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

Under the Portuguese Civil Code, the general rule is that the assignment of credits also implies the transfer of any kind of security or other form of guarantee, unless the relevant assignment agreement provides otherwise. If certain formalities apply to the creation of security, then such formalities also usually need to be complied with for a valid transfer of security. Please see our answers to questions 4.2 and 4.3 regarding the transfer of mortgages under the Securitisation Law and the answer to question 5.5.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

Under the Securitisation Law and the general rule of the Portuguese Civil Code, an obligor may claim any right of set-off (and, in general, any means of defence) against the purchaser of the receivables in the same terms it could be claimed against the seller, if such right of set-off arises from a fact which has occurred prior to the assignment of the relevant receivable. Such right of set-off is not terminated by any notice of assignment. However, where the right of set-off arises from a fact occurring after the assignment of the relevant underlying receivable, the obligor cannot claim the set-off against the amounts owed and neither the purchaser nor the seller shall be liable towards the obligor for damages. As such, the date of assignment is the cut off or crystallisation date for the purposes of exercising set-off or any other means of defence.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Portugal to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

Back-up security in the context of the Securitisation Law is not customary in Portugal, considering that noteholders and secured creditors benefit from the legal creditors’ privilege set forth in Article 63 of the Securitisation Law, which covers the transactions assets located in and outside of Portugal.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Portugal, and for such security interest to be perfected?**

Under Portuguese securitisation transactions, the sellers do not

provide security interests to the receivables, given that such could be considered as jeopardising the true sale nature of the transaction.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Portugal to grant and perfect a security interest in purchased receivables governed by the laws of Portugal and the related security?**

The purchasers in Portuguese securitisation transactions do not usually provide additional security to the noteholders and secured creditors of a given transaction, given that these entities benefit from the legal creditors' privilege mentioned in the answer to question 5.1 above. Other than obtaining the relevant approval for incorporation of the fund or asset digit code approval from the CMVM which confirms the applicability of the legal creditors' privilege in respect of a given portfolio of receivables pertaining to certain notes issued, no additional formalities are required in order to perfect such legal creditors' privilege, given that it is not subject to registration, in accordance with the Securitisation Law. Additionally, in some transactions, namely those using a securitisation fund, it is usual to create security over the foreign bank accounts of the vehicle – see the answer to question 5.7 below.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Portugal, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Portugal or must additional steps be taken in Portugal?**

The security interest would be recognised as valid and effective in Portugal provided that any applicable Portuguese formalities relating to the protection of interested third parties are followed (we refer to the answer to question 5.5 below). For instance, it would be possible to grant an English law pledge over bank accounts (as mentioned above) or over Portuguese law receivables, however, the debtor of those receivables should be notified of such security interest in accordance with Portuguese law in order for it to be effective against said debtor.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

In respect of additional formalities for validly creating security interests in respect to assets abovementioned, we note that formalities regarding evidence to third parties must be followed, such as: (a) security over insurance policies needs to be notified to the relevant insurance provider; (b) security over promissory notes needs to be endorsed by the security grantor to the benefit of the security beneficiary on the relevant title; (c) creation of mortgages or subsequent transfers of entitlements in respect thereof need to be registered with the competent registry office; and (d) security in respect of marketable debt securities needs to be registered either in the relevant securities account (in respect of book-entry securities) or in the relevant title and securities register (in respect of physical securities).

**5.6 Trusts. Does Portugal recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

In general, Portuguese law does not recognise the legal concept of a trust. However, in terms of collections received by the seller pertaining to a given securitisation transaction, we refer to the segregation principle and autonomous estate nature as set out in our answer to question 7.2 below. Furthermore, in respect of collections held by the servicing entity, we would also refer to our answer to question 4.9 above.

**5.7 Bank Accounts. Does Portugal recognise escrow accounts? Can security be taken over a bank account located in Portugal? If so, what is the typical method? Would courts in Portugal recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Portugal?**

Portuguese law does not expressly govern escrow accounts; however, similar types of arrangements can be contractually set up and are commonly used by Portuguese banks. Security interests can be taken over bank accounts in Portugal and the typical method to do so would be by granting a pledge over such bank account. A reference should be made to the form of financial pledges which are the customary method of taking security over bank accounts by financial institutions, financial pledges being governed by the regime of Decree-Law no. 105/2004 of 8 May 2004 (as amended), in line with the financial collateral arrangements directive. The important characteristic of such financial pledges being that the collateral taker may have the possibility to use and dispose of financial collateral provided as the owner of it. English law pledges over Portuguese bank accounts are possible, but the relevant Portuguese bank (as debtor in relation to the balance of that account from time to time) should be notified of the granting of the pledge.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

The Bank Accounts of the transaction may naturally be subject to security to the benefit of the transaction creditors. No specific or autonomous security is usually required as, in fact, Portuguese securitisation transactions have the benefit of a legal special creditor's privilege ("*privilégio creditório especial*") detailed in response to our answer to question 7.2 below, which exists in respect of all assets forming part of the portfolio allocated to each transaction related to an issuance of notes (including the transaction bank accounts) and therefore has effect over those assets existing at any given moment in time for the benefit of the credit securitisation company that are allocated to the relevant issuance of securitisation notes (including the transaction bank accounts, even when located abroad). Upon enforcement, the common representative of the noteholders or the trustee will control the cash flowing into the bank accounts on behalf of the secured creditors and noteholders and will ensure that they are repaid in full.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

The Bank Accounts of the transaction may be subject to security to the benefit of the transaction creditors, as set out in our answer to question 5.8 above. In such context, the owner of the transaction is the Issuer, the securitisation vehicle and it can access the funds standing to the credit of such accounts subject to security prior to enforcement thereof. However, we would note that the issuer is contractually bound to apply the funds in such accounts exclusively in the manner set out in the transaction documents, i.e., by applying such available funds in accordance with the agreed priorities of payments and such utilisation is monitored by the common representative/trustee to the benefit of the holders of the securitisation notes.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Portugal's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

In accordance with Article 6 of the Securitisation Law, the general rule is that the assignment of receivables (described in the answer to question 4.2 above) becomes immediately valid and effective between the parties upon the execution of the relevant assignment agreement, irrespective of the debtor's consent, notification or awareness.

This means that the assignment of the receivables under the Securitisation Law constitutes a valid and true assignment of receivables from the seller to the purchaser; namely to the extent that the insolvency of the seller will not cause the sale or assignment to be declared void from a legal standpoint, and neither any insolvency official, any borrower, nor any creditor of the seller would be able to have set aside such assignment unless it could provide evidence as to the fact that the assignment had been made in bad faith (*vd.* Article 8 of the Securitisation Law). To set aside the assignment conducted on these terms, this would have to be made either by evidencing, in the context of the insolvency, the parties' bad faith or, within the period of five years following completion of the sale of the receivables, through an application for an unenforceability judgment ("*impugnação pauliana*") of such assignment and only providing the claiming party is capable of proving that: (i) the sale of the receivables has decreased the assets or increased the liabilities of the originator; (ii) the claim of the relevant creditor has arisen before completion of the sale of the receivables (although claims arising after completion of the date of receivables may also be affected to the extent that the relevant creditor provides evidence that such sale has been entered with for the specific purpose of avoiding the payment satisfaction of the creditors' claim); (iii) completion of the sale of the receivables has caused or worsened the insolvency situation of the originator; and (iv) both the originator and the purchaser acted in bad faith, that is, both of them were aware that completion of the sale of the receivables would have the effect described in subparagraph (iii) above.

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

Other than as indicated in our answer to question 6.3 below, and on the assumption that a true sale is in place, the only means to prohibit the exercise of rights by the purchaser would be through an injunction ("*providência cautelar não especificada*") followed by the competent main court action.

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Portugal for (a) transactions between unrelated parties, and (b) transactions between related parties?**

Acts that may be qualified as detrimental to the insolvent estate, performed within four years prior to the opening of the corporate insolvency proceedings, may be challenged by the insolvency administrator on behalf of the insolvent estate. The relevant acts for this purpose are those that diminish, frustrate, aggravate, put in danger or delay the rights of the debtor's creditors. These acts can only be challenged if it is proved that they were motivated by the parties' bad faith (where the counterparty to the act or the beneficiary of the act is a person or entity related to the insolvent entity, the relevant act will be deemed to be motivated by bad faith if carried out within a period of two years prior to the opening of the corporate insolvency proceedings).

The parties' bad faith is defined as knowledge of any of the following circumstances on the date of the relevant act:

- that the debtor was insolvent, i.e., unable to fulfil its obligations as they fall due or the debtor's liabilities exceed its assets;
- that the act was of a detrimental nature and that the debtor was in a situation of imminent insolvency; or
- that insolvency proceedings had commenced.

There are certain acts and transactions which are legally deemed to be detrimental to the insolvent company's estate without the need for any additional proof (such as proof of bad faith of any party). This is the case where:

- security was granted within a period of six months prior to the commencement of corporate insolvency proceedings (where such security was granted in respect of pre-existing obligations);
- security was granted simultaneously with the secured obligations, within a period of 60 days prior to the commencement of the corporate insolvency proceedings;
- gratuitous acts (i.e. those for which the debtor did not receive any consideration) were performed less than two years before the commencement of the corporate insolvency proceedings where the act results in a reduction in the assets of the debtor;
- surety, sub-surety, guarantee and credit mandates are given, provided they were issued by the insolvent debtor in the six months preceding the date of the commencement of the corporate insolvency proceedings and do not relate to transactions with any real benefit to the debtor;
- payment of debts or the performance of other acts occur, which have the effect of performing obligations (for example set-off) which would become due after the date on which

insolvency proceedings are commenced (if such payment or set-off occurs during the six months before the opening of the corporate insolvency proceedings);

- (f) payment of debts or the performance of other acts occur, which have the effect of performing obligations (for example set-off) during the six months prior to the opening of the corporate insolvency proceedings if such payment or set-off is considered unusual according to standard commercial practices and the creditor was not able to demand payment;
- (g) acts are performed by the debtor less than a year before the opening of the corporate insolvency proceedings in which the obligations assumed by the debtor significantly exceed those of the counterparty (i.e. transactions at an undervalue); and
- (h) reimbursement of shareholder loans occur, if made in the year that precedes the commencement of the corporate insolvency proceedings.

In any event, it must be noted that, should an assignment of receivable have been made under the Securitisation Law, the burden of proving bad faith is reversed as the assumption that the above typified acts were made in bad faith will not apply. If an assignment of receivables has been made under the Securitisation Law, the relevant interested parties must always prove bad faith in order for the assignment to be declared void.

#### **6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

This is not applicable in the context of the Securitisation Law.

#### **6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Portugal, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

If the assignment of future receivables is made under the Securitisation Law then the indications provided under question 6.1 above will also apply and therefore such future receivables will not form part of the insolvency estate of the seller even when they only become due and payable or come into existence after the date of declaration of insolvency of the seller, provided that the requirements for assignment of future receivables as set out in our answer to question 4.10 are duly complied with prior to the date of declaration of insolvency of the seller.

In case the assignment is not made under the Securitisation Law and the seller becomes insolvent, then the insolvency official may, at its discretion, choose between executing or not executing the receivables sale agreement as this agreement will be suspended by virtue of the declaration of insolvency.

#### **6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

Limited recourse provisions exist on a contractual basis and in accordance with Articles 60 *et seq.* of the Securitisation Law.

However remote a securitisation vehicle's insolvency may be, such a possibility would need to be assessed on a case-by-case basis. In general terms, the debtor is declared insolvent by a Portuguese court where there are no assets to pay debts as they become due. Please note that an insolvency proceeding can nevertheless be started with a Portuguese court by any creditor of the insolvent entity, however insolvency is only declared after the analysis of the debtor's assets and the court's realisation that in fact there are no debtor's assets to pay debts.

## **7 Special Rules**

### **7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Portugal establishing a legal framework for securitisation transactions? If so, what are the basics?**

Generally, the Securitisation Law provides for: (i) the establishment of a standard and specific securitisation legal framework by regulating the establishment and activity of the securitisation vehicles, the type of credits that may be securitised and the entities who may assign credits for securitisation purposes; (ii) a simplification of the assignment process by providing for specific rules on the assignment of credits; and (iii) the expansion of the class of eligible assets to include mortgage loans by providing for a simplified mechanism of assignment of this type of credits.

A special securitisation tax regime is also in place. It was established through Decree-Law no. 219/2001 of 4 August 2011 (as amended from time to time) (the "Securitisation Tax Law").

### **7.2 Securitisation Entities. Does Portugal have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

A flexibility concern seems to have led to the establishment of two different types of securitisation vehicles, the credit securitisation funds ("FTCs") and the credit securitisation companies ("STCs").

The FTC structure is necessarily a tripartite one – (a) the Fund which must be managed by a (b) Fund Manager, pursuant to the terms of the applicable fund regulation and one sole (c) Depository, qualifying as a credit institution, must hold the assets of the Fund.

Fund Managers ("*Sociedade Gestora*"), are financial companies who are required to: (i) hold registered offices and effective management in Portugal; (ii) qualify as a *sociedade anónima* (public limited liability company) whose share capital is represented by nominative or registered bearer shares; (iii) be exclusively engaged in the management of one or more funds on behalf of the holders of Securitisation Units; and (iv) include in its name the expression "SGFTC".

As Fund Managers are financial companies, their incorporation is subject to approval by the Bank of Portugal and their activity is generally subject to supervision by this regulatory authority.

One same Fund Manager may have a number of different funds under management and it is the Fund Manager who is responsible for the application for approval of incorporation of each new fund, by filing the relevant approval request with the CMVM – the entity responsible for approving the incorporation of each new fund through the approval of the relevant fund regulation. The

incorporation of a fund is deemed to occur upon payment of the subscription price for the relevant securitisation units, something that may only occur upon the CMVM's approval having been obtained.

As the FTC itself has no legal personality (it is an autonomous pool of assets held jointly by a different number of entities), its management is entrusted to the Fund Manager who must manage the fund in accordance with the fund regulation and with certain legal limitations on the management of the FTC such as, for example, the requirement that the Funds' funds are used for the initial or subsequent acquisition of credits (for securitisation purposes) and that such credits represent at least 75 per cent of the securitisation Funds' assets.

Of relevant notice is also the fact that Fund managers are subject to specific capital adequacy requirements. A minimum share capital requirement of EUR 250,000 applies while they must have own funds which are equal to, or higher than, a certain percentage of the net value of all funds managed: up to EUR 75 million – 0.5 per cent; in excess of EUR 75 million – 0.1 per cent.

Securitisation companies are companies who are required to: (i) qualify as a *sociedade anónima* (public limited liability company) whose share capital is represented by nominative shares; (ii) include in its name the expression "STC"; and (iii) be exclusively engaged in the carrying out of securitisation transactions by means of acquiring, managing and transferring receivables and of issuing notes as a source of financing such acquisitions.

The incorporation of STCs is subject to an approval process near the CMVM and, although they do not qualify as financial companies, this process imposes compliance with a number of requirements that are similar to those arising under all relevant Banking Law requirements. These requirements may be said to have an impact in terms of the shareholding structure an STC is to have to the extent that full disclosure of both direct and indirect ownership is required for the purposes of allowing the CMVM to assess the reliability and soundness of the relevant shareholding structure. The same applies in respect of the members of corporate bodies, namely directors who must be persons whose reliability and availability must ensure the capacity to run the STC business in a sound and prudent manner.

STCs are also subject to specific capital adequacy requirements. A minimum share capital requirement of EUR 250,000 applies while they must have own funds which are equal to, or higher than, a certain percentage of the net value of issued outstanding securitisation notes: up to EUR 75 million – 0.5 per cent; in excess of EUR 75 million – 0.1 per cent.

In terms of legal attributes and benefits, we believe it is fair to say that both vehicles are quite similar as they both allow for a full segregation of the relevant portfolios and their full dedication to the issued securities. While in a fund structure this is achieved through the structure itself, as the assets of each fund are only available to meet the liabilities of such fund in a company structure, certain relevant legal provisions establish a full segregation principle and a creditors' privileged entitlement over the assets that are so segregated and which collateralise a certain issue of notes.

This segregation principle means that the receivables and other related assets and amounts existing at a given moment for the benefit of an STC, and which are related to a certain issuance of notes, constitute an autonomous and ring-fenced pool of assets ("*património autónomo*") which is exclusively allocated to such issuance of notes and which is not, therefore, available to creditors of the STC other than the noteholders, and to the services providers existing specifically in the context of such issuance of notes until all the amounts due in respect of the notes have been repaid in full. To

this effect, the assets integrated in each *património autónomo* are listed and filed with the CMVM and subject to an asset identification code that is also granted by the CMVM.

In addition to the above, and in order to render this segregation principle effective, the noteholders and the other creditors relating to each series of securitisation notes issued by the STC are further entitled to a legal creditor's privilege (equivalent to a security interest) over all of the assets allocated to the relevant issuance of securitisation notes, including assets located outside Portugal. In fact, according to Article 63 of the Securitisation Law, this legal special creditor's privilege ("*privilegio creditório especial*") exists in respect of all assets forming part of the portfolio allocated to each transaction related to an issuance of notes and therefore has effect over those assets existing at any given moment in time for the benefit of the STC that are allocated to the relevant issuance of securitisation notes.

---

**7.3 Limited-Recourse Clause. Will a court in Portugal give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

---

Yes. The Portuguese general rule on limited recourse provided by Article 602 of the Portuguese Civil Code establishes that a limited recourse provision may be contractually agreed between the debtor and the creditor limiting the debtor's liability to certain available assets. Under this general rule a Portuguese court would enforce and give effect to such a limited recourse provision. Also, limited recourse provisions are specifically valid and binding under the provisions of Articles 60 *et seq.* of the Securitisation Law. Insofar as limited recourse arrangements are concerned, we would furthermore take the view that they correspond to an application in a specific context (that of securitisation) of a possibility of having a contractual limitation on the assets which are liable for certain obligations or debts, which is provided for by Portuguese law on general terms (namely Article 602 of the Portuguese Civil Code). Once they result from the quoted provisions of the law, limited recourse shall not be affected by the issuer's insolvency, however remote, such event may be in the context of the Portuguese securitisation vehicles.

---

**7.4 Non-Petition Clause. Will a court in Portugal give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

---

Non petition, limited recourse and priority of payments arrangements, as usually contained in the securitisation transactions documentation, are valid under Portuguese law, deriving directly from the provisions of Articles 60 *et seq.* of the Securitisation Law.

---

**7.5 Priority of Payments "Waterfall". Will a court in Portugal give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

---

Priority of payments provisions are standard contractual provisions included in Portuguese securitisation transactions (both governed

by Portuguese law, when the vehicle is a securitisation company and governed by a foreign law, usually English law, when the vehicle at stake is a securitisation fund, as in this case, the Issuer is usually an Irish SPV and are valid under Portuguese law and would be given effect by a Portuguese court (but if governed by a foreign law, in the context of a judicial recognition of a foreign court decision – *reconhecimento de sentença estrangeira*).

**7.6 Independent Director. Will a court in Portugal give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

As per the Portuguese Insolvency Code, the commencement of insolvency proceedings is an obligation of the board of directors of any given company that is found to be insolvent and therefore there should not be a limitation as to the fulfilment of this legal obligation.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Portugal, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Portugal? Does the answer to the preceding question change if the purchaser does business with other sellers in Portugal?**

The mere purchase and management of a certain portfolio of receivables does not, in itself, qualify as a banking or financial activity (unless it is to be carried out on a professional and regular basis) and should therefore not give rise to the need for any kind of authorisation or licence being obtained.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

No. When the seller remains in charge of the collection of receivables (as, in fact, is foreseen in the Securitisation Law for example when the seller is a bank, credit institution or other financial company) no licence or authorisation is required for the seller to continue to enforce and collect receivables, including to appear before a court (assuming the debtors are not aware of the assignment). However, should the assignment of the receivables have been notified to the debtors then the servicer will need to show sufficient title to appear in court, like a power of attorney, in case its legitimacy is challenged by the relevant debtor as, in fact, only a fully-fledged creditor has the relevant legitimacy (*“legitimidade processual”*) to claim a certain credit in court.

In case another entity is chosen to perform the role of servicer, a third party replacement servicer is appointed to replace the seller as original servicer or a back-up servicer is required to be put in place, CMVM's approval to this effect is required, under Article 5 of the Securitisation Law.

**8.3 Data Protection. Does Portugal have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

There are, indeed, applicable data protection laws but exclusively in respect of consumer obligors or individuals and not to enterprises. However, the use or dissemination of personal data in respect of directors of enterprises who are individuals will also be subject to restrictions.

Law no. 67/98 of 26 October 1998, (the “Data Protection Law”), which implemented Directive 95/46/EC of 24 October 1995, provides for the protection of individuals regarding the processing and transfer of personal data.

Pursuant to the Data Protection Law, any processing of personal data requires express consent from the data subject, unless the processing is necessary in certain specific circumstances as provided under the relevant laws.

The entity collecting and processing personal data must obtain prior authorisation from the *Comissão Nacional de Protecção de Dados* (the “CNPD”), the Portuguese Data Protection Authority, before processing such data.

Transfer of personal data to an entity within a Member State does not require authorisation by the CNPD but must be notified to the relevant data subjects.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Portugal? Briefly, what is required?**

Portuguese law (namely the Portuguese Constitution, the Civil Code and the Consumer Protection Law) contains general provisions in relation to consumer protection. These provisions cover general principles of information disclosure, information transparency (contractual clauses must be clear, precise and legible) and a general duty of diligence, neutrality and good faith in the negotiation of contracts.

Decree Law no. 446/85 of 25 October 1985, as amended by Decree Law no. 220/95 of 31 July 1995 and Decree Law no. 249/99 of 7 July 1999 (which implemented Directive 93/13/CEE of 5 April 1993) and Decree Law no. 323/2001, of 17 December 2001 known as the *Lei das Cláusulas Contratuais Gerais* (the Law of General Contractual Clauses) prohibits, in general terms, the introduction of abusive clauses in contracts entered into with consumers. Pursuant to this law, a clause is deemed to be abusive if such clause has not been specifically negotiated by the parties and leads to an unbalanced situation insofar as the rights and obligations of the consumer (regarded as the weaker party) and the rights and obligations of the counterparty (regarded as the stronger party) are concerned and the law provides for an extended list of prohibited clauses. The use of such clauses that are prohibited will cause the relevant clauses to be considered null and void.

Decree Law no. 220/94 of 23 August 1994 states the minimum level of information to be included in loans, such as the annual effective.

**8.5 Currency Restrictions. Does Portugal have laws restricting the exchange of Portugal's currency for other currencies or the making of payments in Portugal's currency to persons outside the country?**

Other than in international embargo circumstances, there are no

laws in Portugal restricting foreign exchange transactions or free international capital movements.

We would note, in addition, that if the debt securities/notes issued by the funding vehicle are cleared through Interbolsa - Sociedade Gestora de Sistemas de Liquidação e de Sistemas Centralizados de Valores Mobiliários, S.A. (“**Interbolsa**”), as operator of the Portuguese centralised securities system, then payments can only be made in the currencies accepted by Interbolsa. For the time being, Interbolsa will only settle and clear notes denominated in euros, Canadian dollars, Swiss francs, US dollars, Sterling and Japanese yen and notes denominated in any other currency upon prior request and approval.

## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Portugal? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

The Securitisation Tax Law has established the tax regime applicable to the securitisation transactions carried out under the Securitisation Law. Its main goal was to ensure a tax neutral treatment to the securitisation transactions set up by each one of the securitisation vehicles provided for in the Securitisation Law. Therefore, under Articles 2(5) and 3(4) of the Securitisation Tax Law, there is no withholding tax on (i) the payments made by the purchaser (either an STC or an FTC) to the seller in respect of the purchase of the receivables, (ii) the payments by the obligors under the loans, and (iii) the payments of collections by the servicer (who usually is also the seller) to the purchaser are not subject to Portuguese withholding tax. The nature or the characteristics of the receivables and the location of the seller do not have any influence on the tax regime referred to above. However the purchaser must be an STC or an FTC resident for tax purposes in Portugal in order to benefit from the special tax regime. There is no re-characterisation risk of the deferred purchase price as payments of collections are not subject to withholding tax.

On the other hand, payments of interest and principal in respect of the various series of securitisation notes/units the purchaser issues are exempt from Portuguese income tax, including withholding tax, provided the relevant noteholder or unitholder qualifies as a non-Portuguese resident having no permanent establishment in Portugal. This exemption shall cease to apply if, for some reason: (i) more than 25 per cent of the share capital of the relevant noteholder or unitholder is held, either directly or indirectly, by Portuguese residents; or (ii) the relevant noteholder or unitholder becomes a resident of a jurisdiction listed as a tax haven in Ministerial Order no. 150/2011 of 13 February 2011, as amended from time to time, namely by Ministerial Order no. 292/2011 of 8 November 2011. To qualify for the exemption, noteholders or unitholders will be required to provide the Issuer with adequate evidence of non-residence status prior to the respective interest payment date, according to requirements and procedures set forth in the Securitisation Tax Law.

**9.2 Seller Tax Accounting. Does Portugal require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

No specific tax accounting requirements need to be complied with by the seller under the securitisation regime. However, the CMVM Regulation no. 1/2002 of 5 February 2002, sets forth the specific accountancy regime for the FTC, and the CMVM Regulation no. 12/2002 of 18 July 2002, establishes specific accountancy rules for the STC (although the accounting procedure of this type of corporate entity follows the general Portuguese Accountancy Standards).

**9.3 Stamp Duty, etc. Does Portugal impose stamp duty or other documentary taxes on sales of receivables?**

Pursuant to the Securitisation Tax Regime, no stamp duty is due on: (i) the sale of receivables being securitised; or (ii) the fees and commissions which fall under Article 5 (i.e. referring to acts necessary to ensure a good management of the receivables and, if applicable, of the respective guarantees, and to ensure collection services, the administrative services relating to the receivables, all relations with the debtors and also maintaining, modifying and extinguishing acts related to guarantees, if any) and under Article 24 (i.e. referring to any of the described attributions of the depositary), both of the Securitisation Law, that may be charged by the servicer to the purchaser. In addition, no documentary taxes are due in Portugal.

**9.4 Value Added Taxes. Does Portugal impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

The sale of receivables is VAT exempt under Articles 9(27)(a) and (c) of the Portuguese VAT Code, which are in line with Article 135(a) and (c) of the VAT Directive (EC Directive 2006/112/EC). Pursuant to the Securitisation Tax Regime, no Value Added Tax is due on the administration or management of securitisation funds and also on the fees and commissions regarding management services which fall under Article 5 and transactions undertaken by depositary entities pursuant to Article 24 of the Securitisation Law, as described in our answer to question 9.3 above.

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

This is not applicable since the assignment of the receivables benefits from a stamp tax and a VAT exemption.

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Portugal, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Portugal?**

Considering the above, it is important to highlight that the purchase of the receivables is qualified as a true sale transaction under the

Securitisation Law, the purchaser being the legal owner of the receivables and therefore the purchaser is subject to tax in Portugal (namely in respect of income arising from the receivables). However, despite being viewed as an ordinary taxpayer, in order to

ensure a tax neutral treatment on the securitisation transactions, the taxable income of the purchaser tends to be equivalent to zero for tax purposes since the income payments made to the noteholders/unitholders are tax-deductible.



#### Paula Gomes Freire

Vieira de Almeida & Associados -  
Sociedade de Advogados, R.L.  
Av. Eng. Duarte Pacheco, no. 26  
1070-110 Lisbon  
Portugal

Tel: +351 21 311 3479  
Fax: +351 21 352 2239  
Email: [pgf@vda.pt](mailto:pgf@vda.pt)  
URL: [www.vda.pt](http://www.vda.pt)

Law degree, University of Lisbon, Faculty of Law. Post-graduate studies in English Commercial Law, College of Law, London University.

Joined Vieira de Almeida & Associados in 1996. She is a partner in the Banking & Finance area of practice where she has been actively involved in several transactions, in Portugal and abroad, mainly focused on the issue and placement of debt and equity instruments, namely EMTN programmes, commercial paper, preferential shares and public offerings. She has also been actively working on securitisation transactions and other types of asset-backed transactions.

Before joining the firm she worked as an associate at McKenna&Co, in London and at Azevedo Neves, Benjamim Mendes, Pereira de Miranda & Associados, in Lisbon. She is admitted to the Portuguese Bar Association and the Law Society of England and Wales.



#### Benedita Aires

Vieira de Almeida & Associados -  
Sociedade de Advogados, R.L.  
Av. Eng. Duarte Pacheco, no. 26  
1070-110 Lisbon  
Portugal

Tel: +351 21 311 3677  
Fax: +351 21 352 2239  
Email: [bla@vda.pt](mailto:bla@vda.pt)  
URL: [www.vda.pt](http://www.vda.pt)

Law degree, University of Oporto, Faculty of Law. Post-graduate degree in Banking Law, University of Lisbon, Faculty of Law. Post-graduate degree in Commercial Law, Portuguese Catholic University, Faculty of Law. LL.M. Advanced Master of Law, Católica Global School of Law.

Joined Vieira de Almeida & Associados in 2003 and is currently a senior associate in the Banking & Finance practice area where she has been actively involved in several transactions, in Portugal and abroad, mainly focused on the issue and placement of debt and equity instruments and other structured financial products and classic financing. She has also been actively working in securitisation transactions, covered bonds issuances and other types of asset-backed transactions and recently in bank recapitalisation transactions and issuances of regulatory capital instruments.

Seconded to Clifford Chance LLP, London office, integrating the Structured Debt team from 2007 to 2008.

She is admitted to the Portuguese Bar Association and registered as a European Registered Lawyer.



Established in 1976, our firm's innovative approach has been a stepping stone for our growth. We led some of the most important and ground breaking transactions that took place in the financial and infrastructural sectors in the last decades. Our team of more than 170 lawyers provides high quality services and advice on the following practice areas: Banking & Finance; Competition & EU; Litigation & Arbitration; Insolvency & Restructuring; Corporate & Governance; Tax; Real Estate & Environment; Employment & Benefits; M&A; Corporate Finance; Capital Markets; Public Law; Privacy, Data Protection & Cybersecurity; Projects - Infrastructure, Energy & Natural Resources; Intellectual Property; Life Sciences; Planning & Tourism; Telecoms & Media; and IT & Outsourcing.

Through VdAtlas, the firm's international platform, we provide our clients with a professional network based on exclusive or preferential relations in the Portuguese speaking countries, Europe, South America, Asia and in the world's main financial centres, bringing together highly specialised local support with a profound knowledge of the client's business. We have developed a particular expertise in Mozambique, Angola and Brazil, where VdA has been involved in some of the biggest transactions that have taken place in such markets.

VdA has seen its work recognised through several awards, such as The Lawyer Iberian Law Firm 2013, Financial Times Most Innovative Law Firm in Europe 2013, NYSE Euronext Most Active Law Firm 2012, 2013 and 2014, Who's Who Legal Law Firm of the Year 2013 and 2012 and IFLR European Awards 2012.



# Scotland



Bruce Stephen



Marion MacInnes

Brodies LLP

## 1 Receivables Contracts

**1.1 Formalities.** In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

It is generally not necessary for the sale of goods or services to be evidenced by a formal receivables contract. Certain types of contract are required to be in writing in order to be binding between the parties. An invoice in conjunction with the actings of the parties may be sufficient to establish a contract between the parties and evidence a debt.

**1.2 Consumer Protections.** Do Scotland's laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

In consumer credit arrangements, there are statutory restrictions which may affect interest chargeable. Excessive interest could be challenged if, prior to 6 April 2007, it constituted an extortionate credit transaction under s.137 of the Consumer Credit Act 1974 (the CCA) and from 6 April 2007 it constituted an unfair relationship under s.140A of the CCA. Default interest provisions which are penalties may be unenforceable. Certain provisions in consumer contracts may be unenforceable as being unfair under the Unfair Terms in Consumer Contracts Regulations 1999.

The Late Payment of Commercial Debts (Interest) Act 1998 provides for payment of interest in commercial transactions where the parties have not specified that interest is payable following late payment under the contract. The Act applies to commercial contracts for the sale of goods and services but does not apply to consumer contracts.

The CCA contains consumer protections regarding certain forms of consumer credit arrangements including the ability for the consumer to cancel receivables contracts within a specified period of time.

**1.3 Government Receivables.** Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

With the exception of potential immunity issues associated with state entities, there are no different requirements and laws applicable to the sale or collection of receivables from the government or government agencies in Scotland.

## 2 Choice of Law - Receivables Contracts

**2.1 No Law Specified.** If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Scotland that will determine the governing law of the contract?

The choice of law is determined with reference to the Contracts (Applicable Law) Act 1990 (the 1990 Act), the Rome I Regulation (Regulation (EC) 593/2008, dated 17 June 2008) or Scots common law. The 1990 Act applies the Rome Convention on contractual obligations (the **Rome Convention**) in respect of contracts entered into, on, or before 17 December 2009 and the Rome I Regulation applies to contracts entered into after that date.

Under the Rome Convention, in the absence of an express choice of law, the principle of closest connection is applied in determining the law of the contract. Closest connection is presumed to be: the country where a party who is to effect the performance of the contract has its habitual residence (or equivalent), unless the contract is entered into in the course of a party's trade or profession in which case the closest connection is presumed to be the country in which the party's principal business is located; or if performance is in another place of business, the country where that other place of business is located.

Under the Rome I Regulation, the position is similar, save that habitual residence is a fixed rule with exceptions for particular contract classes where specific rules apply. If, however, it is clear that the contract is more closely connected with the law of a different country, the law of that country is the applicable law.

To the extent the relevant contract is beyond the scope of the 1990 Act or the Rome I Regulation, Scots common law will determine the choice of law where the contract is silent. Scots common law applies the ‘proper law’ to the contract, this being the law which the parties intended or may fairly be presumed to have intended to invoke in creating the contractual relationship.

**2.2 Base Case.** If the seller and the obligor are both resident in Scotland, and the transactions giving rise to the receivables and the payment of the receivables take place in Scotland, and the seller and the obligor choose the law of Scotland to govern the receivables contract, is there any reason why a court in Scotland would not give effect to their choice of law?

No, there is not.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor.** If the seller is resident in Scotland but the obligor is not, or if the obligor is resident in Scotland but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Scotland give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

The parties may expressly choose the governing law relating to the contract and such choice will be recognised by the Scottish courts under certain exceptions specified under the 1990 Act or the Rome I Regulation. For contracts beyond the scope of the 1990 Act or the Rome I Regulation, the Scottish courts are likely, subject to issues of public policy, to recognise the express choice of law of the parties provided such choice of law coincides with the intention of the parties. It should be noted that, to the extent a law other than Scots law is expressly applied to the contract, such choice of law would need to be pled in order for it to be recognised by the Scottish courts.

**2.4 CISG.** Is the United Nations Convention on the International Sale of Goods in effect in Scotland?

The Convention is not in effect in Scotland.

### 3 Choice of Law - Receivables Purchase Agreement

**3.1 Base Case.** Does Scotland's law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Scotland's laws or foreign laws)?

The parties are generally permitted to choose the law to govern contractual obligations between them including those arising under a receivables purchase agreement.

It is common for portfolios of Scottish receivables to be sold under a contract governed by a law other than Scots law. It is not necessary for the contract of sale to be governed by the same law as the underlying receivables. To the extent that the sale contract creates rights to the underlying receivables beyond mere contractual rights (for example, the purchaser acquiring an equitable proprietary interest in the underlying receivables by execution of the sale contract only), it is unlikely that such additional rights would be effective in respect of Scottish receivables without further action being required.

**3.2 Example 1:** If (a) the seller and the obligor are located in Scotland, (b) the receivable is governed by the law of Scotland, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Scotland to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Scotland, will a court in Scotland recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes, the Scottish courts will recognise the express choice of Scots law.

**3.3 Example 2:** Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Scotland, will a court in Scotland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

It is likely that the Scottish courts will recognise the sale contract and in particular give effect to the sale to the purchaser in questions against the seller and any creditor of, or insolvency practitioner appointed to, the seller. The effect of the sale contract in questions against the relevant obligor and the purchaser may require local country law to be considered.

**3.4 Example 3:** If (a) the seller is located in Scotland but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Scotland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Scotland's own sale requirements?

It is likely that the Scottish courts will recognise the choice of law in respect of the sale contract and will not require any additional Scots law formalities to be complied with in order to give effect to the transfer of the receivables pursuant to the sale in questions against the seller, the creditors of, or insolvency administrator appointed to, the seller.

**3.5 Example 4:** If (a) the obligor is located in Scotland but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Scotland recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Scotland's own sale requirements?

See the answer to question 3.4 above.

**3.6 Example 5: If (a) the seller is located in Scotland (irrespective of the obligor's location), (b) the receivable is governed by the law of Scotland, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Scotland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Scotland and any third party creditor or insolvency administrator of any such obligor)?**

It is likely that the Scottish courts will recognise the choice of law in respect of the sale contract. On the basis that the receivables are governed by Scots law, the transfer of the receivables pursuant to the sale in compliance with the requirements of the purchaser's country will be recognised by the Scottish courts provided they also comply with the Scots law requirements in respect of the transfer of such receivables.

## 4 Asset Sales

**4.1 Sale Methods Generally. In Scotland what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

The most common way for a seller to sell receivables to a purchaser is by means of a sale contract supported by an assignment or assignment of the receivables with notice to the relevant obligors or where notice is unattractive (or inconsistent with arrangements to be put in place in other jurisdictions for that particular portfolio) then a trust is declared over the relevant interests under the receivables contracts and related receivables and cash receipts. Scots law does not recognise equitable transfers in respect of Scottish assets and, accordingly, an equitable assignment of the receivable would not, as a matter of Scots law, pass a proprietary interest in the receivables to the purchaser. The trust would, however, create a protected interest in the Scottish receivables which would be good against the seller or any insolvency official appointed to the seller.

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

The sale of Scottish receivables is perfected by the relevant obligors receiving notice of the assignment. Scots law recognises various forms of notice. While the assignment is effective from the date of receipt of notice by the obligor, an acknowledgment of such notice provides evidence of both receipt and understanding of the new arrangements by the relevant obligor.

If the same receivables are assigned by the seller to several third party purchasers all acting in good faith, the order of priority between such purchasers is determined by the date of receipt of notice by the obligor of the assignments. Accordingly, a subsequent third party purchaser who acquires in good faith and notifies the obligor first will take a better title to the receivables than the first purchaser and any intervening purchaser.

**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

Mortgage loans and related security are transferred by formal assignment with notice and, in the case of the transfer of the mortgage security, by registration of such transfer at the Scottish land registers. Many securitisations are structured on the basis of equitable assignments of mortgage loans and related security. Generally, such arrangements are implemented in Scotland by means of an express trust.

Securities which are in bearer form are generally transferable by mere delivery of the relevant security certificate. Instruments which are negotiable in nature may be transferred by a combination of endorsement and delivery with, in certain circumstances, notice to the relevant obligor under the instrument.

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

Notice is a requirement of Scots law for the formal transfer of the seller's interest in the receivable. Prior to notification the obligor can obtain a valid discharge of the debt by paying the seller. The proprietary interest in the receivable remains with the seller until notice of the transfer is given to the obligor. Consequently, unless a trust has been declared over the receivables, such interests are available to the creditors of the seller on insolvency.

The consent of the obligor to the sale is not necessary unless expressly required under the contract or unless the principle of *delictus personae* applies (the contract being of a nature specific to the parties to it). The contract does not need to contain an express permission for a party's interest to be assignable.

Notice has the effect of limiting rights of set-off affecting the receivables arising from other ongoing arrangements between the obligor and the seller. The purchaser acquires the receivable subject to any existing rights of set-off the obligor has against the seller. Notice also prevents the obligor from obtaining a valid discharge of the debt from the seller.

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

The form of notice is not prescribed under Scots law. Various forms of notice or intimation are recognised including those permitted by

the Transmission of Moveable Property (Scotland) Act 1862. The 1862 Act provides for notarial intimation and postal intimation. In the latter case, to obtain the benefit of the terms of the Act, the intimation should contain a certified true copy of the assignation. The notice can be delivered after the sale. The transfer would, however, be subject to the rights of parties who have effected diligence in the meantime, third party purchasers acquiring in good faith, perfected security holders and insolvency officials appointed to the seller. The intimation can be delivered after the commencement of insolvency proceedings against the obligor. The impact of insolvency of the seller is considered in the answer to question 6.1 below.

While an assignation of receivables arising under future contracts is theoretically possible under Scots law, the position is subject to much academic debate and issues arise around the ability to clearly identify the receivable in question. It is a fundamental principle of Scots law for the assignation to be effective that the receivable is either identified or identifiable. Accordingly, assignments of receivables arising under future contracts should be treated with care.

---

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?**

---

Restrictions of this nature (whether expressed in relation to the assignation or transfer of rights or obligations under the Agreement or relating to the assignation or transfer of the Agreement itself) will generally be interpreted as prohibiting a transfer at least in any question between the purchaser and any obligor. Dependent upon the purchaser's awareness of the prohibition and the terms of the assignation itself, the purchaser may have a claim against the seller for failing to transfer title to the receivables.

---

**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Scotland? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Scotland recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

---

Such restrictions are generally enforceable in Scotland. There are no particular exceptions to this rule. If a sale or assignment is effected in breach of a prohibition, the sale or assignment is likely to be ineffective as between the seller and the obligor. A claim for damages for breach of contract may also be available to the obligor against the seller.

---

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells *all* of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

---

The receivables must be identified or identifiable for the purposes of the sale and transfer of the receivables. The receivables must be ascertainable for the purpose of any transfer. Relevant information usually includes the obligor's name, invoice number, invoice date and amount. The receivables being sold do not need to share objective characteristics. It is possible for the seller to contract to sell all of their receivables to the purchaser or all receivables other than those specifically excluded (and identifiable). It is unlikely that this would be sufficient to identify the receivables for the purpose of an assignation and notice.

---

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

---

A transaction expressed to be a sale may be re-characterised by the courts in Scotland as potentially a secured financing in certain circumstances. A true sale analysis of the sale is usually undertaken. In the Scottish context, this involves reviewing the transaction documentation and deal structure and considering the tests applicable in the English case of *Re Inglefield* and an assessment of the 'ultimate right' in the receivables sold.

No single factor will result in the transaction being characterised as a sale or a secured financing. Retention of credit risk by the seller may suggest that the purchaser has not truly acquired the receivables and accordingly buy back provisions are required to be formulated with care. Again, interest rate risk may be characterised as either an indication of true ownership being retained by the seller or merely a purchase price adjustment mechanism. Control of collections of receivables when such services are provided for a commensurate fee and where the seller does not retain any economic exposure to the receivables either for failing to collect or entitlement to profit from collection is unlikely, in itself, to result in the sale being re-characterised.

---

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

---

The seller can agree in an enforceable manner to a continuous sale of receivables as and when they arise (at least so far as the purchaser acquiring a contractual right to the receivables) provided such receivables are identifiable. Such contractual arrangements would be effective until the insolvency of the seller.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?**

See question 4.10 above. The transfer of such receivables to the purchaser would, however, need to be documented separately and an automatic transfer of such receivables (at least in respect of Scottish receivables) is unlikely to be recognised by the Scottish courts without the Scottish formalities being met. To the extent relating to future receivables, we would generally recommend that express supplemental trusts are declared over receivables as and when they are originated (or regularly in batches) pending formal transfer of the receivables to the purchaser.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

Each relevant interest should be transferred in accordance with the formal transfer requirements under Scots law unless the security is held on a security trust basis. Related security is generally assigned to the purchaser under Scots law and notice given to obligors or registrations at the relevant Scottish land register depending upon the security involved. Under Scots law, an assignation has the effect of ‘ruling off’ the liabilities secured by the related security at the time of the transfer even if the security is expressed as being for “all sums”. Accordingly, further advances would be unsecured unless the security is amended or new security is granted to support the further advance. Pending formal transfer, a trust is commonly declared in favour of the purchaser over the receivables and related security. This can also cover certain ancillary rights which are difficult to formally transfer to the purchaser.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

The obligor’s rights of set-off continue after notice of a sale and related assignation is given to the obligor but only in respect of amounts which were subsisting prior to such notice being given. Accordingly any new liabilities of the seller to the obligor arising after notice of the sale and assignation has been given to the obligor will be excluded from the obligor’s rights of set-off.

The purchaser should not be liable to the obligor for damages caused by set-off rights being restricted after the assignation of the Receivable. Depending upon the terms of the Agreement and any other arrangement between the obligor and the seller, the obligor may have a claim of damages against the seller for losses suffered as a result of set-off rights being restricted after the transfer of the Receivable.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Scotland to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

It is not customary in Scotland to take back up security over the seller’s interest in the receivables in the event that the sale is deemed by the court not to have been perfected or being re-characterised as a secured financing.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Scotland, and for such security interest to be perfected?**

The formalities for granting fixed security over receivables are similar to those in respect of the transfer of such an interest. Accordingly, the receivable should be assigned to the purchaser and notice given to the obligor. The form of security required in respect of related security interests will depend upon the security involved. In addition, a corporate seller may grant a floating charge over its assets including the receivables and related security.

The security may also need to be registered at Companies House.

The Financial Collateral Arrangements No.2 Regulations 2003 also apply in Scotland.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Scotland to grant and perfect a security interest in purchased receivables governed by the laws of Scotland and the related security?**

The answer is the same as that to question 5.2 above. The purchaser may also hold an interest as beneficiary under a trust declared by the seller over the relevant receivables. Such an interest is capable of being subject to fixed security by means of an assignation duly intimated to the seller.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Scotland, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Scotland or must additional steps be taken in Scotland?**

To the extent that the receivables are governed by Scots law, the Scottish courts may not recognise any security granted over such receivables which falls short of the Scots law formalities in respect of such security. The appropriate form of security is set out under question 5.2 above.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

See questions 4.3 and 4.12 above.

- 5.6 Trusts. Does Scotland recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Trusts are recognised as a matter of Scots law under the Recognition of Trusts Act 1987.

- 5.7 Bank Accounts. Does Scotland recognise escrow accounts? Can security be taken over a bank account located in Scotland? If so, what is the typical method? Would courts in Scotland recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Scotland?**

Scotland recognises arrangements whereby parties hold funds in a designated account and agree to the release of such amounts following satisfaction of certain conditions or on the consent of all relevant parties. Security can be created over bank accounts in Scotland. Certain issues arise in respect of security granted over accounts in favour of the account bank. In such circumstances the security relies upon the operation of set-off. The typical method of taking security is by means of a bank account pledge and assignation duly intimated to the account bank. The Scottish courts would recognise a foreign law grant of security taken over a bank account to the extent that the form of security complies with the Scots law formalities for such a charge.

- 5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

The rights of the account bank (such as rights of set-off) will usually be waived under the security and any acknowledgment to be signed by them. All amounts received into the account are secured. An arrestor of the bank account should rank behind the holder of an existing duly perfected account charge. Insolvency should not affect the validity of any fixed security over sums subsequently received into the bank account although in practice an insolvency official may seek to divert payments which the purchaser is only contractually obliged to procure are made to such an account. The terms of the bank account security itself can affect the position.

- 5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Control by the account holder over the funds in the account is inconsistent with a duly perfected charge under Scots law. Accordingly any such arrangements, which occur frequently in practice, would affect the security. The relevant account should be blocked in order for effective security to be created in Scotland.

## 6 Insolvency Laws

- 6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Scotland's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

Most insolvency proceedings for corporate entities provide for some form of automatic stay of action or moratorium preventing court proceedings from being raised or enforcement action being taken against the insolvent entity or its assets for a period of time without either the insolvency practitioner's consent or consent of the court. This would prohibit the purchaser from collecting, transferring or otherwise exercising, ownership rights over the purchased receivables to the extent they continued to be assets of the seller at the time of commencement of insolvency proceedings. If, however, ownership of the receivables have been transferred to the purchaser and that transfer has been perfected, the purchaser could sue the obligor in its own name without reference to the insolvent entity.

- 6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

On the basis that the receivables have been transferred to the purchaser and that transfer has been perfected, the insolvency official should have no power to interfere with the purchaser's exercise of rights in respect of the receivables unless the transfer is capable of challenge under the various creditor protection provisions outlined under question 6.3 below.

- 6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Scotland for (a) transactions between unrelated parties, and (b) transactions between related parties?**

UK Insolvency legislation contains creditor protections which give rise to suspect periods during which transactions may be rescinded or reversed. Certain protections have UK-wide application and, as such, also apply in Scotland (for example, s.245 (Avoidance of certain floating charges) of the Insolvency Act 1986). Transactions entered into by Scottish companies and certain overseas companies may be subject to the provisions of ss.242 and 243 of the 1986 Act (Gratuitous Alienations and Unfair Preferences) and to Scots common law equivalents.

The relevant period to challenge a gratuitous alienation is five years for a transaction with a connected party and two years for any other person and the period for challenge of an unfair preference is six months. An alienation cannot be challenged as gratuitous if: (i) immediately or at any other time after the alienation the company's assets were greater than its liabilities; or (ii) the alienation was made for adequate consideration. An unfair preference is a

transaction which has the effect of creating a preference in favour of a creditor to the prejudice of the general body of creditors. A transaction is not a preference if (i) it is in the ordinary course of trade or business, or (ii) it involves the parties undertaking reciprocal obligations unless the transaction was collusive with the purpose of prejudicing the general body of creditors.

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

This doctrine is not recognised under Scots law. In addition, the courts will only pierce the corporate veil in very limited circumstances.

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Scotland, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

The contractual obligations continue albeit the purchaser is likely to have only a claim against the seller's estate which will rank with other unsecured creditors. As the future Scottish receivables are not transferred to the purchaser without further action of the seller (i.e., the grant of an assignment duly notified to the relevant obligors), the Scottish receivables will remain the property of the seller unless the insolvency official transfers the receivables to the purchaser pursuant to the sale contract.

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

Much will depend upon the terms of the limited recourse wording. Generally limited recourse provisions will result in the liability being extinguished by the realisation of the relevant assets and application of proceeds in satisfaction of the equivalent value of debt (any balance being cancelled). As such they are asset/liability-neutral. Scottish corporate debtors can be declared insolvent if, among other things, their liabilities exceed their assets. They can also be declared insolvent if a creditor has served on the debtor a written demand for payment and the debtor has failed to pay such demand within the prescribed period. The limited recourse wording should be checked to establish whether or not it permits the creditor to serve such a demand. A Scottish corporate debtor may also be declared insolvent if it is proved to the court that the company is unable to pay its debts as they fall due. The debtor's whole assets and liabilities position needs to be taken into account when considering this final test.

## 7 Special Rules

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Scotland establishing a legal framework for securitisation transactions? If so, what are the basics?**

There is no special securitisation law or special provisions in other

law in Scotland establishing a legal framework for securitisation transactions, although particular tax laws may apply.

**7.2 Securitisation Entities. Does Scotland have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

There are no mandatory or special requirements in respect of the establishment of special-purpose entities for securitisations in Scotland.

**7.3 Limited-Recourse Clause. Will a court in Scotland give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

Generally, the courts in Scotland would recognise a limited-recourse clause.

**7.4 Non-Petition Clause. Will a court in Scotland give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

Although there is no direct Scottish authority in this regard, non-petition clauses are likely to be valid in Scotland provided such provisions are not contrary to public policy. A Scottish court might still accept a winding up petition contrary to the terms of a non-petition clause resulting instead in only a damages claim for breach.

**7.5 Priority of Payments "Waterfall". Will a court in Scotland give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

Yes. Pre-insolvency of the purchaser, contractual arrangements fixing the priority of distributions are of a type which would be recognised by the Scottish courts. Priority of payments of unsecured amounts post insolvency may still be recognised, however, as a general rule an insolvency official would not be bound by the terms of such provisions and is required to pay creditors in accordance with statutory rules. Payments in breach of such arrangements will create only contractual claims against the parties to the contract.

**7.6 Independent Director. Will a court in Scotland give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

As a matter of UK company law, directors are unable to limit the exercise of their powers. Constitutional documents may be drafted

so as to require director consent for certain actions. However to the extent such provisions are contrary to public policy they would be unenforceable. The directors have overriding duties to creditors including, where appropriate, to call for winding up or administration of a corporate entity in certain circumstances. It is unlikely that such provisions would be overridden by contractual or constitutional document provisions.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Scotland, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Scotland? Does the answer to the preceding question change if the purchaser does business with other sellers in Scotland?**

The acquisition, collection or ownership of receivables will not in itself result in the purchaser being required to do business or to obtain a licence or its being subject to regulation as a financial institution in Scotland unless such activities are regulated (for example, origination or administration of regulated mortgage contracts for which FCA authorisation would be required) or constitute consumer credit activities (for which a consumer credit licence would be required). In either case, Data Protection Act registration should also be obtained.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

Servicing activities are likely to require a CCA licence or require FCA authorisation if they relate to consumer credit activities or regulated activities. Any third party replacement servicer will require the same licences and authorisations.

**8.3 Data Protection. Does Scotland have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

The provisions of the Data Protection Act 1998 apply in Scotland. The laws apply only to individuals and not to enterprises.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Scotland? Briefly, what is required?**

If the obligors are consumers, the purchaser will probably be required to comply with the UK consumer credit protection laws and to be licensed under the CCA.

If the contract constitutes a regulated mortgage contract (or equivalent regulated contract) for the purposes of the Financial Services and Markets Act 2000, the purchaser would need to be authorised by the FCA and comply with the detailed requirements of the FCA Handbook relating to such contracts.

Certain unfair terms in consumer contracts may not be enforceable against the consumer. Similarly, provisions in a contract, which purport to restrict liability of a party for damage caused, may be restricted or struck at by the Unfair Contract Terms Act 1977.

**8.5 Currency Restrictions. Does Scotland have laws restricting the exchange of Scotland's currency for other currencies or the making of payments in Scotland's currency to persons outside the country?**

Subject to currency transfer and dealing restrictions applicable under current United Nations Sanctions and to compliance with anti-money laundering/anti-terrorism legislation, there are no restrictions on currency exchange or the making of payments to persons outside Scotland.

## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Scotland? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

Withholding tax is subject to UK-wide legislation. Accordingly, the Scottish rules follow that applicable elsewhere in the UK (including in respect of the potential recharacterisation of any deferred purchase price). In summary, withholding tax applies in respect of payments of interest unless the purchaser is resident in the UK, or carries on business in the UK through a permanent establishment. Withholding tax may be subject to treaty relief under a Double Taxation Convention, though there are practical difficulties in particular cases.

**9.2 Seller Tax Accounting. Does Scotland require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

The seller tax treatment follows the UK tax requirements, which are based on the accounting treatment subject to specific regulations.

**9.3 Stamp Duty, etc. Does Scotland impose stamp duty or other documentary taxes on sales of receivables?**

Certain documents are subject to stamp duty in Scotland and certain transactions to the extent not documented are subject to stamp duty reserve tax (SDRT). The transfer of mortgages, lease and trade receivables and finance payments are normally exempt from stamp duty and SDRT.

**9.4 Value Added Taxes. Does Scotland impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

VAT is generally payable in Scotland in respect of the supply of



goods and services within the UK by taxable persons in the course or furtherance of a business. The current standard rate of VAT is 20 per cent, although different rates apply depending upon the goods or services supplied. Certain supplies are exempt and some transfers are outside the scope of VAT.

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

To the extent payable, VAT has to be accounted for by the provider of services only (i.e., the seller). Stamp duty liability falls to the party seeking to enforce the transfer (i.e., the purchaser). Generally,

HM Revenue & Customs would not have a claim against the purchaser for VAT for which the seller had to account.

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Scotland, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Scotland?**

The purchase of receivables by the purchaser or its appointment of the seller as its servicer and collection agent should not, in itself, result in the purchaser being liable to pay tax in Scotland; however, as with the rest of the UK, enforcement of receivables may require more detailed consideration. In each case all circumstances need to be considered and advice obtained.



**Bruce Stephen**

Brodies LLP  
15 Atholl Crescent  
Edinburgh, EH3 8HA  
Scotland

Tel: +44 131 656 0260  
Fax: +44 131 228 3878  
Email: [bruce.stephen@brodies.com](mailto:bruce.stephen@brodies.com)  
URL: [www.brodies.com](http://www.brodies.com)

Bruce is head of the Banking and Finance Department at Brodies and runs the securitisation practice at the firm. A recognised specialist in the UK independent legal directories, Bruce is both Scots and English law qualified and has considerable experience in advising in all forms of receivables finance and securitisations including CMBS, RMBS, trade receivables and autoloan securitisations as well as large loan book acquisitions and related finance and related enforcement and restructuring work.

He is the author of the Scottish chapter on security over receivables: an international handbook published by Oxford University Press and was one of the lead advisers involved in drafting the bank insolvency and bank administration rules applicable to banks in Scotland (being secondary legislation issued pursuant to the Banking Act 2009).

Bruce's full profile is available at: [www.brodies.com/people/bruce-stephen](http://www.brodies.com/people/bruce-stephen).



**Marion MacInnes**

Brodies LLP  
15 Atholl Crescent  
Edinburgh, EH3 8HA  
Scotland

Tel: +44 131 656 0288  
Fax: +44 131 228 3878  
Email: [marion.macinnes@brodies.com](mailto:marion.macinnes@brodies.com)  
URL: [www.brodies.com](http://www.brodies.com)

Marion is a Senior Associate in Brodies' Banking and Finance Department. She has extensive experience acting for financial institutions, corporates and investors on a wide range of complex leveraged finance, project finance, structured finance and securitisation transactions.

Marion has advised on the Scottish aspects of a number of securitisation transactions involving a diverse range of asset classes from real estate-backed securitisations (including both residential and commercial property) to non-real estate asset securitisations involving lease, HP and vehicle receivables. She also has experience advising on the Scottish aspects of mortgage loan portfolio acquisitions and sales (acquired portfolios and originated) including back-to-back sales.

Marion's full profile is available at: [www.brodies.com/people/marion-macinnes](http://www.brodies.com/people/marion-macinnes).

**BRODIES**<sup>LLP</sup>

Brodies LLP is the Scottish-headquartered law firm offering clients the largest specialist legal resource in Scotland. As well as having the highest concentration of practice areas ranked in the top tiers by independent international legal directories, the firm has won industry awards and plaudits for its client services, innovation, use of technology, commercial awareness and business acumen. With offices in Edinburgh, Glasgow, Aberdeen and Brussels, Brodies provides business-focused advice to virtually every sector of the Scottish economy.

One of the few specialist securitisation teams in the country, Brodies offers expertise and experience spanning all asset classes with track record in CMBS, RMBS, trade receivables and auto and equipment HP/hire contract securitisations, conduit structures and pre-securitisation warehousing finance acting for originator groups, trustees, arrangers and special servicers.

# Singapore



Petrus Huang



Ron Cheng

## Drew & Napier LLC

### 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

It is not legally necessary for the sales of goods or services to be evidenced by a formal receivables contract. From an evidentiary point of view, it is advisable to have a written receivables contract in place. However, a debt obligation may equally be enforceable if there is a verbal or implied agreement giving rise to that obligation and which is supported by consideration. An implied agreement can be established through the conduct of the respective parties. Invoices may constitute evidence as to the existence of a contract, especially if the respective parties have a pre-existing business relationship of a similar kind contemplated in the invoice.

**1.2 Consumer Protections. Do Singapore’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

Section 23(1) of the *Moneylenders Act* (Cap. 188, 2010 Revised Edition) provides that when proceedings are brought in any court by a licensed moneylender for the recovery of a loan or the enforcement of a contract for a loan or any guarantee or security given for a loan, and the court is satisfied that the interest or late interest charged in respect of the loan is excessive and that the transaction is unconscionable or substantially unfair, the court shall re-open the transaction and take an account between the licensee and the person being sued. Section 23(5) provides that where a licensed moneylender has filed, in the bankruptcy of a borrower or surety, proof of debt arising from a loan granted by him, the official assignee may exercise such powers as may be exercised by a court when assessing whether the debt or liability is proved, and its value.

Rule 11(2) of the *Moneylenders Rules 2009* provides that the maximum rate of interest on a loan by a registered moneylender shall be: (a) in the case of a secured loan not exceeding \$3,000 granted to an individual whose annual income on the date of the grant for the loan is less than \$20,000, 12 per cent *per annum*; and

(b) in the case of an unsecured loan not exceeding \$3,000 granted to an individual whose annual income on the date of the grant for the loan is less than \$20,000, 18 per cent *per annum*. In the case of a loan that does not exceed \$3,000 granted to an individual whose annual income on the date of the grant for the loan is less than \$20,000, Rule 11(3) provides that the maximum rate of late interest shall be the rate of interest charged on the amount of the loan actually disbursed. Rule 11(4) provides that in Rule 11(2) and subject to Rule 11(5): “secured loan” means any loan given with security; and “unsecured loan” means any loan given without security. The government has announced impending changes in the manner in which such interest rate is to be calculated and the relevant legislation is expected to be introduced soon.

Section 23(6) of the *Moneylenders Act* provides that where in any proceedings in court initiated by a licensed moneylender to enforce a loan or where proof of a debt has been filed against a borrower, it is found that the interest or late interest charged on any loan exceeds such maximum rate of interest or late interest as may be prescribed for the loan, the court or the official assignee, as the case may be, shall presume, unless the contrary is proved, that the interest or late interest charged in respect of the loan is excessive and that the transaction is unconscionable or substantially unfair.

Save for the foregoing, there is no limit on the rate of interest on consumer credit, loans or other kinds of receivables provided that:

- (i) any interest imposed for delays in payment is a genuine pre-estimate of loss and not an *in terrorem* penalty;
- (ii) any interest imposed on consumer credit, loans and other receivables arose from *bona fide* contracts for the sale of goods and services and are not disguised money-lending sham transactions which would otherwise require licensing under the *Moneylenders Act* (Cap. 188), nor is the interest, or late interest charged, excessive and unconscionable or substantially unfair;
- (iii) the terms of the contract with a person dealing as consumer are reasonable within the meaning of the *Unfair Contract Terms Act* (Cap. 396); and
- (iv) the interest imposed does not amount to an extortionate credit transaction within the meaning of section 103 of the *Bankruptcy Act* (Cap. 20), such transaction may be voided by the court if it was entered into three years before the commencement of the bankruptcy of the consumer.

Save for the foregoing, we are not aware of any statutory provisions in Singapore providing for a statutory right to interest on late payments on receivables or for other noteworthy rights to consumers with respect to receivables.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

Claims against the Singapore government (which includes certain Singapore government-owned or government-controlled entities established in Singapore) would be subject to the defence of sovereign immunity and to the provisions of the *Government Contracts Act* (Cap. 118).

Section 7(1) of the *Government Proceedings Act* provides that, notwithstanding any other provisions of the *Government Proceedings Act* to the contrary, no proceedings, other than proceedings for a breach of contract, shall lie against the government on account of anything done or omitted to be done or refused to be done by the government or any public officer in exercise of the public duties of the government.

Section 10(1) of the *Government Proceedings Act* provides that all debts due and claims owing from time to time by any person to the government, whether upon judgment, bond, or other specialty, or upon simple contract or otherwise, shall be entitled from the date of the accrual thereof, respectively, to a preference of payment over all debts or claims of every kind which shall, subsequent to such date, have been contracted or incurred by, or become due from, such person to any other person whomsoever. Section 10(2) provides that nothing in section 10 shall affect any right vested in any person by virtue of a mortgage or charge of immovable property duly registered in the manner provided by law for the registration of such mortgage or charge.

## 2 Choice of Law - Receivables Contracts

**2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Singapore that will determine the governing law of the contract?**

Singapore courts generally embark upon three stages in determining the governing law of a contract. The first stage is to determine if there is an express choice of governing law. If there is none, the second stage is to determine whether an intention of the parties to choose a governing law could be inferred. If the court was faced with a multiplicity of factors, each pointing to a different governing law, then the proper approach would be to move on to the third stage, which was to determine the law with the closest and most real connection with the contract.

The aim of the third stage is to consider, on balance, which law had the closest connection with the contract in question and the circumstances surrounding the inception of that contract. The “closest and most real connection” test was the same as the objective test of what the reasonable man ought to have intended if he had thought about the matter at the time when he made the contract.

**2.2 Base Case. If the seller and the obligor are both resident in Singapore, and the transactions giving rise to the receivables and the payment of the receivables take place in Singapore, and the seller and the obligor choose the law of Singapore to govern the receivables contract, is there any reason why a court in Singapore would not give effect to their choice of law?**

A Singapore court would give effect to a contractual choice of governing law in the receivables contract, unless the choice of law

was contrary to public policy, illegal, or made in bad faith. On the circumstances of the base case, the court in Singapore would give effect to their choice of law.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Singapore but the obligor is not, or if the obligor is resident in Singapore but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Singapore give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

A Singapore court would give effect to a contractual choice of governing law in the receivables contract, unless the choice of law was contrary to public policy, illegal or made in bad faith. If the seller and/or obligor are resident in Singapore and the contractual choice of governing law is some other law than Singapore law, this would be a factor in considering whether such choice of law was made in bad faith but would not for this reason alone result in the Singapore court refusing to recognise such foreign choice of law. If, additionally, the payment of receivables takes place in Singapore, this would be taken into consideration as to whether such choice of non-Singapore law was made in bad faith.

Section 27(2) of the *Unfair Contract Terms Act* (Cap. 396) provides that: “... this Act has effect notwithstanding any contract term which applies or purports to apply the law of some country outside Singapore, where (either or both): (a) the term appears to the court, or arbitrator or arbiter to have been imposed wholly or mainly for the purpose of enabling the party imposing it to evade the operation of this Act; or (b) in the making of the contract one of the parties *dealt as consumer*, and he was then habitually resident in Singapore, and the essential steps necessary for the making of the contract were taken there, whether by him or by others on his behalf” [*emphasis added*].

**2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Singapore?**

Section 3(1) of the *Sale of Goods (United Nations Convention) Act* (Chapter 283A) provides that subject to section 3(2), the provisions of the United Nations Convention on Contracts for the International Sale of Goods adopted in Vienna, Austria, on 10 April 1980 (“Convention”) shall have the force of law in Singapore. Section 3(2) provides that Article 1 paragraph (1)(b) of the Convention shall not have the force of law in Singapore and accordingly the Convention will apply to contracts of the sale of goods only between those parties whose places of business are in different States when the States are contracting States to the Convention.

Section 4 provides that the provisions of the Convention shall prevail over any other law in force in Singapore to the extent of any inconsistency. Hence, the Convention does not apply when the contract of the sale of goods is between parties whose places of business are in Singapore and a non-contracting State respectively.

### 3 Choice of Law - Receivables Purchase Agreement

#### 3.1 Base Case. Does Singapore law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Singapore's laws or foreign laws)?

There is no general rule under Singapore law requiring the sale of receivables (i.e. the sale agreement) to be governed by the same law as the law governing the receivables themselves. However, questions regarding assignability and perfection would be governed by the law of the receivables and not by the governing law of the sale agreement. Furthermore, the enforceability or recoverability of receivables may be determined by the law governing the receivables, irrespective of the law governing the sale agreement.

It should be noted in passing that certain rights may well be incapable of assignment under foreign law. In Singapore (i) pensions and salaries payable out of national funds to public officers, (ii) a bare right of litigation, and (iii) rights under contracts that involve personal skill or confidence, are examples of rights that cannot be assigned. As such, 'assignees' of such 'rights' may not be able to enforce those rights as against the obligor.

#### 3.2 Example 1: If (a) the seller and the obligor are located in Singapore, (b) the receivable is governed by the law of Singapore, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Singapore to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Singapore, will a court in Singapore recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

A Singapore court would give effect to a contractual choice of governing law in the receivables contract and the sale agreement, unless the choice of law in either case was contrary to public policy, illegal, or made in bad faith. In the given hypothetical situation, without further information which may qualify our response, it is likely that a Singapore court would recognise the sale as being effective against the seller, the obligor and other third parties.

#### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Singapore, will a court in Singapore recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

A Singapore court would give effect to a contractual choice of governing law in the receivables contract and the sale agreement, unless the choice of law in either case was contrary to public policy, illegal or made in bad faith. In the given hypothetical situation, the fact that the obligor and/or the purchaser do not reside in Singapore would be taken into consideration as to whether such choice of Singapore law was made in bad faith. A Singapore court will also look at whether the payment of receivables takes place outside of Singapore.

If the obligor is located in Singapore, the assignability of the obligations of such obligor and the validity of such obligations in the event of bankruptcy or liquidation of such obligor would be governed by Singapore law.

If the seller is a corporation incorporated in Singapore, the question of such seller's capacity to contract for the sale of the receivable, the perfection of such assignment by way of sale of such receivable, and the validity of such sale in the event of liquidation of such seller would be governed by Singapore law.

#### 3.4 Example 3: If (a) the seller is located in Singapore but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Singapore recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Singapore's own sale requirements?

Assuming that Singapore is an appropriate forum for an action to be brought against the seller and other third parties, a Singapore court will generally give effect to the contractual choice of governing law in respect of the receivables contract and the sale agreement respectively, i.e. the law of the obligor's country in the given hypothetical situation, unless the choice of law was contrary to public policy, illegal or made in bad faith. If the laws of the obligor's country are upheld as the governing law of the receivables contract and the sale agreement respectively, the sale requirements under Singapore law will not apply.

If the seller is a corporation incorporated in Singapore, the question of such seller's capacity to contract for the sale of the receivable, the perfection of such assignment by way of sale of such receivable, and the validity of such sale in the event of bankruptcy or liquidation of such seller would be governed by Singapore law.

#### 3.5 Example 4: If (a) the obligor is located in Singapore but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Singapore recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Singapore's own sale requirements?

Assuming that Singapore is an appropriate forum for an action to be brought against the obligor and other third parties, a Singapore court will generally give effect to the contractual choice of governing law in respect of the receivables contract and the sale agreement respectively, i.e. the law of the seller's country in the given hypothetical situation, unless the choice of law was contrary to public policy, illegal or made in bad faith. If the obligor is located in Singapore, the assignability of the obligations of such obligor and the validity of such obligations in the event of liquidation of such obligor would be governed by Singapore law.

**3.6 Example 5:** If (a) the seller is located in Singapore (irrespective of the obligor's location), (b) the receivable is governed by the law of Singapore, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Singapore recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Singapore and any third party creditor or insolvency administrator of any such obligor)?

In the given hypothetical situation, without further information that may qualify our response and assuming that Singapore is an appropriate forum for such an action to be brought against the relevant parties:

If the seller is a corporation incorporated in Singapore, the question of such seller's capacity to contract for the sale of the receivable, the perfection of such assignment by way of the sale of such receivable, and the validity of such sale in the event of liquidation of such seller would be governed by Singapore law.

If the obligor is located in Singapore, the assignability of the obligations of such obligor and the validity of such obligations in the event of bankruptcy or liquidation of such obligor would be governed by Singapore law.

## 4 Asset Sales

**4.1 Sale Methods Generally.** In Singapore what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

Accounts receivable are generally sold by way of an assignment or, in the case of future receivables, by way of an agreement for the assignment of receivables when they come into existence. Assignments can take the form of legal assignments (if certain procedural requirements are complied with) or equitable assignments (which is essentially an assignment that does not meet the requirements of a legal assignment).

For a valid legal assignment in Singapore, the following requirements must be complied with:

- (a) the contract between the obligor and seller must permit such assignment;
- (b) the assignment must be absolute;
- (c) the assignment is of a 'debt or other legal chose in action';
- (d) the assignment must be in writing under the hand of the assignor; and
- (e) express notice in writing must be given to the obligor.

Another common method of selling receivables is by way of novation, where all parties (i.e. the obligor, seller and purchaser) agree to the transfer of the rights and obligations of the seller in the underlying contract to the purchaser for a nominal consideration paid to the obligor. If the obligor is cooperative, novations are generally simpler to effect and enforce than assignments.

Finally, another method of selling receivables is by way of declaration of trust.

There is no specific customary terminology applicable. It depends on the mode of sale of the receivables to the purchaser.

**4.2 Perfection Generally.** What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

For perfection of an equitable assignment of receivables, the procedural requirements described under question 4.1 in relation to legal assignments must be satisfied. This usually requires that a written notice be provided to the obligor.

If the first purchaser obtains a legal assignment of the receivables (i.e. no perfection of title required), such first purchaser enjoys priority over all subsequent good faith purchasers for value of the same receivables purchased from the seller (*Second Purchaser*).

However, if the first purchaser obtains an equitable assignment of the receivables, then such first purchaser will lose priority to a Second Purchaser unless the latter was not *bona fide* or was aware of the earlier purchase by the first purchaser at the time the Second Purchaser was assigned the same receivables. It follows that the first purchaser should give notice of the assignment to the obligor in order to perfect its title against a Second Purchaser.

**4.3 Perfection for Promissory Notes, etc.** What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

In Singapore, mortgage loans are transferred by assignment, as with any other loan. However, for the accompanying mortgage to be transferred, registration of the mortgage (for registered land) or registration of a transfer (for unregistered land) must be effected with the Singapore Land Authority for a fee.

A negotiable instrument is transferred by an act of negotiation, such as delivery or endorsement. The transfer of bills of exchange and promissory notes is dealt with in the *Bills of Exchange Act* (Cap. 23). Generally, a bearer instrument is transferred by delivery and a registered instrument is transferred by entry in the appropriate register.

Marketable debt securities (i.e. book-entry interests in instruments) which are held in a clearing system will generally be transferred by arrangement with the institution holding the account in the clearing system in which the instruments are held, either directly or through an intermediary custodian.

With regard to consumer loans, please refer to our response to question 8.4.

**4.4 Obligor Notification or Consent.** Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

The seller, being a party to the receivables contract, does not need to give further notice to enforce the contract against the obligor. The purchaser (assignee), however, will need to notify the obligor in order to enforce the receivables contract against the obligor without the need to join the seller (assignor) as a party to the

proceedings. It is not necessary to obtain the obligor's consent to the assignment if there is no express prohibition of such assignment in the receivables contract.

In relation to enforcing the receivables contract or the receivables purchase agreement against the trustee-in-bankruptcy or liquidator (as the case may be) of the obligor/seller in Singapore, the trustee-in-bankruptcy or liquidator may be able to challenge such sale or assignment of receivables if the transaction was (i) an unfair preference, (ii) at an undervalue, or (iii) an extortionate credit transaction. For a brief explanation of these terms, refer to our response to question 6.3.

Our answer does not change if there is no express clause in the receivables contract prohibiting assignment. However, if there is such a clause prohibiting assignment, then the purchaser will not have any legal right to claim directly from the obligor and would have to join the seller in the legal proceedings against the obligor (unless prior consent of the obligor was obtained).

Generally, a purchaser-assignee will be subject to equities that existed prior to the notice of assignment given to the obligor. Such equities may include rights of set-off that may have existed between the obligor and the seller-assignor. If, however, notice is not required for perfecting a sale, i.e. the purchaser maintains a direct right of action against the obligor on the strength of the sale agreement without the need to join the seller as a party (which is not the case under Singapore law), giving notice to the obligor may additionally preserve the obligor's assets and avoid the situation where the obligor mistakenly pays the seller under the receivables contract.

---

**4.5 Notice Mechanics.** If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

---

The notice must be given in writing, but there is no particular method of delivery prescribed. A notice of assignment can be delivered contemporaneously with or after the assignment of receivables, subject to the proviso that an assignment without notice being given (i.e. an equitable assignment) will remain vulnerable in terms of priority to intervening assignments of which notice is given to the obligor. This would also apply after insolvency proceedings against the obligor have commenced, subject to the proviso that there may be enforcement restrictions.

The notice may apply to both specific and future receivables, subject to our further response to question 4.6 below.

---

**4.6 Restrictions on Assignment - General Interpretation.** Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?

---

A restriction in a receivables contract in the terms described is

likely to be interpreted as prohibiting a transfer of such receivables by the seller and would not be binding on the obligor. The result is likely to be the same if the restriction was worded in the latter manner described above.

---

**4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Singapore? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Singapore recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

---

Such restrictions in a receivables contract in the terms described above will be generally enforced in Singapore. If the seller nevertheless attempts to sell the receivables to the purchaser, the seller will be liable to the obligor for breach of such receivables contract.

---

**4.8 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells *all* of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

---

A contract to sell receivables must describe the receivables so that they are capable of being identified at the time of the purported assignment (or at the time they come into existence, for a sale of future receivables). It must be clear what is being assigned. If the sale is by declaration of trust, the subject matter of the trust, i.e. the receivables being sold, must be sufficiently certain and the respective interests of the purchaser and any other beneficiaries of the trust must be capable of determination at any time. There is no requirement for the receivables being sold to share objective characteristics.

The phrase "all of its receivables" (used in either case) may not be sufficient for the purposes of the contract. The questions of what constitutes such "receivables", the exact amounts owing under such receivables and the date and time of such ascertainment could cause problems with defining the scope of the assignment. Additionally, the wide phraseology could include debts owing to the assignor which were never intended to form part of the assignment (e.g. rebates).

The recommended alternative is to identify clearly in the contract the receivables and the amounts owing thereunder.

**4.9 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

For a sale of receivables to be treated as perfected and as a ‘true sale’, it must avoid being classed as a sham transaction or recharacterised as a secured loan. It must also not be vulnerable upon the seller’s insolvency.

A transaction may be found to be a sham when the written document does not properly reflect the actual agreement between the parties. There must be a common intention by the parties to conceal the actual agreement – an element of impropriety or dishonesty. In this case, the court will ignore the document and rewrite the agreement to reflect the real rights and obligations. The Singapore courts look at the substance of a transaction rather than just the label given to it by the parties. If the document claims to be a sale, the court will examine whether it creates rights and obligations consistent with a sale (“whether it is in truth what it purports to be”). It is not relevant that the economic effect of the transaction is indistinguishable from a secured loan (“not what the transaction is”). The court will look at the description of the agreement and determine whether the actual rights and obligations of the parties created by the agreement are consistent with this description.

As regards queries (a) and (b), it would not be consistent with a ‘true sale’ for the seller to retain the credit risk or an interest rate risk.

As regards query (c), upon the sale of the receivables, the purchaser should obtain unencumbered ownership of the receivables which it has purchased, such that it has the sole right *vis-à-vis* the control of collections of receivables. If the seller is allowed to retain control of collections of receivables, such retention of control should be provided in an agreement making clear that the seller is collecting the receivables on behalf of the purchaser.

As regards query (d), if the seller retained a right of repurchase, the transaction may as a result be characterised as being more akin to a conditional sale or even a secured loan. If the seller retained a right of redemption, the transaction may as a result be characterised as being more akin to a charge or mortgage. The seller retaining a right of repurchase/redemption in the sale is not consistent with the notion of a ‘true sale’.

**4.10 Continuous Sales of Receivables.** Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

The seller can agree in an enforceable manner with the purchaser to continuous sales of receivables under an agreement to assign. However, notice is still required to perfect the assignment, and prior to that, the assignment will remain vulnerable in terms of priority to intervening assignments of which notice is given to the obligor.

**4.11 Future Receivables.** Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

The seller can agree in an enforceable manner with the purchaser to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement under an agreement to assign. However, notice is still required to perfect the assignment, and prior to that, the assignment will remain vulnerable in terms of priority to intervening assignments of which notice is given to the obligor.

Prior to a seller’s insolvency, an assignment for valuable consideration of receivables that do not exist at the time of the assignment will be treated as an agreement to assign, and will not be a legal assignment. Pursuant to section 4(8) of the *Civil Law Act*, there are three conditions that must be satisfied if an assignment is to derive validity from the statute: (a) it must be absolute; (b) it must be written; and (c) written notice must be given to the debtor. This agreement will operate to assign the receivables as soon as they come into existence (and written notice to the debtor is still required to perfect the assignment).

Once the seller enters into insolvency proceedings, a previous agreement to assign future receivables will only continue automatically to transfer receivables as they arise where there is nothing further to be done by the seller in order to be entitled to the receivables.

**4.12 Related Security.** Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

The customary methods for a seller to transfer related security to a purchaser would depend on the nature of such related security.

Where the related security comprises stock, shares or bonds, the transfer of such related security would usually be a mortgage, or charge, or an assignment by way of charge.

Where the related security comprises goods or other inventory, and if the giver of the security is a corporation (and not an individual), the transfer of such related security may be by way of an assignment of debenture.

Where the related security comprises immovable property or interests in immovable property, the transfer of such security would be by way of assignment of mortgage.

If not all related security can be enforceably transferred, an undertaking by the seller to hold such related security on trust for the purchaser could be considered to provide the purchaser the benefits of such related security.

**4.13 Set-Off; Liability to Obligor.** Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?

Where a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, it is likely that the obligor's set-off rights will terminate upon its receipt of notice of a sale unless: (a) the receivables contract provides that the obligor has a right of set-off against the seller and that such obligation of the seller is novated to the buyer; or (b) an equitable set-off arises from the facts. (The general requirements for establishing equitable set-off falls outside the scope of this chapter.)

Where a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, it is not clear whether the seller is liable to the obligor for damages caused by such termination.

## 5 Security Issues

**5.1 Back-up Security.** Is it customary in Singapore to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

The Singapore "true sale" analysis (based on legal principles set out in question 4.9 above) would therefore require that all aspects of the transaction be consistent with a sale of receivables rather than a secured loan.

Registering a 'back-up' security (such as a charge) might prejudice the true sale analysis since it would indicate that (a) the parties were uncertain of their intentions, and (b) that the parties may not have intended an outright sale of the receivables. It is therefore not advisable to create a 'back-up' security interest in a true sale of a receivables contract.

**5.2 Seller Security.** If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Singapore, and for such security interest to be perfected?

Please also see our response to question 5.1.

**5.3 Purchaser Security.** If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Singapore to grant and perfect a security interest in purchased receivables governed by the laws of Singapore and the related security?

The formalities for the purchaser granting a security interest and the perfection of such security interest in respect of various categories of assets in Singapore are as follows:

- (a) receivables generally (secured by way of assignment thereof and perfected by way of notice of assignment to the obligor);
- (b) stocks, shares or bonds (secured by way of a mortgage or charge thereof and perfected by way of registering the security holder or its nominee in the register of members as the registered holder of such stocks, shares or bonds. The creation of such charge by a Singapore company should also be entered into the register of charges of such Singapore company);
- (c) goods or other inventory (secured by way of a charge in the form of a debenture by a Singapore company in favour of the security holder and the creation of such charge in the register of charges of such Singapore company); and
- (d) immovable property or interests in immovable property (secured by way of a mortgage or an assignment of mortgage thereof and perfected by way of registering the security holder's interest in the Register of Land Titles against such immovable property. The creation of such charge by a Singapore company should also be entered into the register of charges of such Singapore company).

**5.4 Recognition.** If the purchaser grants a security interest in receivables governed by the laws of Singapore, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Singapore or must additional steps be taken in Singapore?

In Singapore, questions of a proprietary nature (in relation to receivables) are generally governed by the law governing the receivables. Thus, the effect of granting a security interest over receivables, the application of the rules of priority to the receivables and the requirements to perfect security in the receivables against the underlying debtor will be determined by the law governing the receivables. If the seller is a corporation incorporated in Singapore, the question of such seller's capacity to grant such security interest in such receivables, the perfection of such security interest over such receivables, and the validity of such grant of such security interest in the event of liquidation of such seller would be governed by Singapore law.

**5.5 Additional Formalities.** What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Where the security interest in mortgage loans creates an interest in real property, such security interest should be registered with the Singapore Land Authority pursuant to section 37 of the *Land Titles Act* (Cap. 157) in the case of registered land, and pursuant to section 5 of the *Registration of Deeds Act* (Cap. 269) in the case of land which is not registered under the *Land Titles Act*. Where such a security interest should be registered but is not registered, it will be void as against any subsequent *bona fide* purchaser or mortgagee for valuable consideration of the secured property.

Security interests granted over book-entry securities held in the Central Depository (Pte) Limited may be created by way of a statutory security upon compliance with the requisite filing of security forms or by way of a security interest under common law.

Security interest in negotiable instruments, including bearer debt securities and promissory notes, may be created in the form of a pledge over such negotiable instruments.



- 5.6 Trusts. Does Singapore recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Trusts are recognised under the laws of Singapore.

- 5.7 Bank Accounts. Does Singapore recognise escrow accounts? Can security be taken over a bank account located in Singapore? If so, what is the typical method? Would courts in Singapore recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Singapore?**

Escrow accounts are recognised by Singapore law. Security may be taken over a bank account located in Singapore and typically such security is by way of an assignment by way of charge over such bank account.

The courts in Singapore would recognise a foreign law grant of security over a bank account located in Singapore subject to the perfection requirements under Singapore law.

- 5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

Where security over a bank account is effected and the secured party enforces that security, the security documentation would usually provide that the secured party has control over all cash flowing into the bank account from enforcement forward until the secured party is repaid in full.

- 5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Where security over a bank account is effected, it is possible for the security documentation to provide that owner of the account can have restricted access to the funds in the account prior to enforcement. If it is intended that the security over such bank account be by way of a fixed charge, such restricted access should be carefully structured to retain control by the security trustee to minimise the possibility of the legal status of the security being regarded as a floating charge.

## 6 Insolvency Laws

- 6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Singapore's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

The purchaser would be entitled to deal with the receivables in Singapore as the owner of the receivables if there was a 'true sale' of the receivables and subject to such sale by the seller not being an unfair preference or at an undervalue and not being an extortionate credit transaction. This would apply notwithstanding the subsequent insolvency or bankruptcy of the seller. The insolvency official would not have the ability to stay collection and enforcement actions.

If the sale of receivables was not a "true sale" and instead was treated as a secured loan, such grant of security would be void against a liquidator and other creditors of a Singapore corporate seller if such charge were not lodged with the Registrar of Companies within 30 days of creation of such charge (Section 131, *Companies Act* (Cap. 50)).

An agreement to assign future receivables will operate to transfer those receivables when they come into existence but where there is any insolvency of such assignor and if any action is needed on the part of such assignor to transfer the receivables, the purchaser would not be entitled to assume that such assignor will continue to carry out those actions.

When a judicial management order is made in respect of a Singapore company, any receiver shall vacate office and no execution or other legal process shall be commenced against the company or its property, except with the consent of the judicial manager or with leave of the court. Similarly, no steps shall be taken to enforce security over the company's property or to repossess any goods except with the consent of the judicial manager or with leave of the court.

- 6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

In the case of a "true sale", the insolvency official would not have that power.

- 6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Singapore for (a) transactions between unrelated parties, and (b) transactions between related parties?**

In the case of a 'true sale' that is not an unfair preference or at an undervalue and is not an extortionate credit transaction, the

insolvency official would not have the power to prohibit the purchaser's exercise of rights.

#### Transactions at an undervalue

The insolvency official could reverse transactions at an undervalue which took place five years before the commencement of insolvency proceedings. A transaction at an undervalue is one where the insolvent party (a) made a gift to another person or enters into a transaction for which the insolvent party receives no consideration, (b) enters into a transaction with another person in consideration of marriage, or (c) enters into a transaction for a consideration the value of which is significantly less than the value of the receivables.

#### Unfair preference

The insolvency official could reverse transactions where the insolvent party intended and gave an unfair preference to any creditor, surety or guarantor (*Recipient*) for any of the insolvent party's debts or other liabilities, where the Recipient will be in a better position than they would be in the event of the insolvent party's bankruptcy, and where such preference was given within two years (or, for a preference where the Recipient is not an associate of the insolvent party, six months). There is no general doctrine of substantive consolidation under Singapore law. Only in very limited circumstances would the separate legal personality of a company be ignored (e.g. fraud).

#### Extortionate credit transactions

The insolvency official could reverse extortionate credit transactions within three years before the commencement of the insolvency proceedings. A transaction is presumed extortionate if (a) grossly exorbitant payments are to be made by the insolvent party in consideration of its receipt of credit, or (b) if the terms of the credit transaction were harsh and unconscionable or substantially unfair.

---

#### **6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

---

Generally, the insolvency of a company will merely involve the consolidation of the available assets and liabilities of that company. In very limited circumstances (e.g. fraud), the courts will pierce the veil of incorporation and look to the assets of other companies (such as its affiliates) for such consolidation.

---

#### **6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Singapore, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

---

Once the seller enters into insolvency proceedings, a previous agreement to assign future receivables will only continue automatically to transfer receivables as they arise where there is nothing further to be done by the seller in order to earn the receivables.

---

#### **6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

---

Where a debtor's contract contains a limited recourse provision (see question 7.3 below), it is possible for the debtor nevertheless to be declared insolvent on the grounds that it cannot pay its debts as they become due.

---

## 7 Special Rules

---



---

#### **7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Singapore establishing a legal framework for securitisation transactions? If so, what are the basics?**

---

The MAS has issued Notice No. 628 pursuant to section 55 of the *Banking Act* (Cap. 19) which applies to all banks in Singapore. Part I (sections 3 to 5 and the Annexes) of the Notice sets out mandatory requirements, with the exception of footnotes labelled as guidelines, and Part II (section 6) sets out non-mandatory guidelines on the responsibilities of banks in respect of securitisation. The MAS has issued a similar Notice 832 (Risk Based Capital Adequacy Requirements) in respect of finance companies.

There is also provision in section 13P of the Income Tax Act (Chapter 134) for exemption of income derived by an approved securitisation company resident in Singapore from asset securitisation transactions, subject to certain prescribed conditions being fulfilled. The implementing regulations *viz.* the Income Tax (Exemption of Income of Approved Securitisation Company) Regulations 2008 are in force. The MAS has also recently updated its Circular (FSD Cir 01/2013) to Financial Institutions in Singapore on the extension of such tax incentive scheme for approved special purpose vehicle engaged in asset securitisation transactions.

Other than the foregoing (see our responses to questions 9.1 and 9.6 below), there appears to be no other statutory provisions specifically governing securitisation transactions.

---

#### **7.2 Securitisation Entities. Does Singapore have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

---

The MAS Notice No. 628 referred to in question 7.1 above provides for the establishment of special purpose entities for securitisation by banks. Annex A of the said Notice provides that any bank acting as an asset-back commercial paper programme sponsor, a manager or an originator shall not, *inter alia*, in relation to the special purpose entity (SPE) used in the securitisation:

- (a) in the case where the SPE is a corporation, own any share capital in the SPE, including ordinary or preference shares, or in the case where the SPE is a trust, own any share capital in the trustee or be a beneficiary of the SPE;
- (b) name the SPE in such manner as to imply any connection with the bank;
- (c) have any director, officer or employee on the board of the SPE unless: (i) the board is made up of at least three

members the majority of whom are independent directors; and (ii) the officer representing the bank does not have veto powers;

- (d) directly or indirectly control the SPE; or
- (e) provide implicit support or bear any of the recurring expenses of the securitisation.

Aside from the abovementioned Notice, there are no laws specifically providing for establishment of special purpose entities for securitisation.

**7.3 Limited-Recourse Clause. Will a court in Singapore give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

It is likely that such a contractual provision would be regarded as valid and upheld by the Singapore courts.

**7.4 Non-Petition Clause. Will a court in Singapore give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

It is likely that a non-petition clause is valid, although there is little authority either way in Singapore law. A court would have to consider whether such a clause was contrary to public policy as an attempt to oust the jurisdiction of the court or the insolvency laws of Singapore. It is possible that a Singapore court would deal with a winding-up petition even if it was presented in breach of a non-petition clause.

**7.5 Priority of Payments "Waterfall". Will a court in Singapore give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

It is likely that a contractual provision in an agreement relating to the distribution of payments to parties in a certain order specified in the contract would be enforceable subject to overriding statutory provisions, particularly in the event of insolvency of the payor. For instance, payments by a Singapore company would be subject to the statutory payment priorities of section 328 of the Companies Act (Chapter 50).

**7.6 Independent Director. Will a court in Singapore give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

A restriction or limitation in the articles of association of a company on the ability of a director to bring insolvency proceedings may be invalid as a matter of public policy, or as a fetter on the proper regulation of a limited company.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Singapore, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Singapore? Does the answer to the preceding question change if the purchaser does business with other sellers in Singapore?**

If the purchaser continues to purchase and enforce receivables successively and repetitively with a view to commercial gain (especially if it does business with other sellers in Singapore), it may be regarded as carrying on business in Singapore. Relevant factors in considering whether or not a foreign company is carrying on business in Singapore would include by way of example:

- (a) the establishment of a place of business in Singapore;
- (b) the employment of an employee or agent in connection with the business;
- (c) the raising of loans or finance;
- (d) collection of information or soliciting of business; and
- (e) trading within Singapore.

However, the mere purchase and ownership of receivables (without any form of physical presence in Singapore, either through the establishment of an office or having employees present in Singapore) should not, in itself, be regarded as a carrying on of business in Singapore.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

No licence is required for a seller to enforce and collect receivables. However, in the course of doing so, a seller who is not a licensed advocate and solicitor of Singapore cannot (in its own capacity or as agent for the purchaser) (i) issue any writ, summons or process, (ii) commence, carry on, solicit or defend any action, suit or other proceeding in the name of any other person or in his own name in any of the courts in Singapore, or (iii) draw or prepare any document or instrument relating to any proceeding in such courts.

A seller also cannot, for any fee, gain or reward, do any of the following: (a) directly or indirectly draw or prepare any document or instrument relating to any movable property (which would include receivables) or to any legal proceeding; and (b) on behalf of a claimant write, publish or send a letter or notice threatening legal proceedings other than a letter or notice that the matter will be handed to a solicitor for legal proceedings.

For all intents and purposes, the position of a third party replacement servicer (who is not an advocate and solicitor) is the same as that of the seller.

**8.3 Data Protection. Does Singapore have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

The Personal Data Protection Act 2012 governs the collection, use and dissemination of personal data by organisations and covers

“personal data” which is defined broadly as all data from which an individual can be identified. An individual’s consent will be required before an organisation can collect, use or disclose the individual’s personal data, unless required or authorised by law.

---

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Singapore? Briefly, what is required?**

---

In Singapore, the terms of a contract with a person dealing as a consumer must be reasonable within the meaning of the *Unfair Contract Terms Act* (Cap. 396). The *Consumer Protection (Fair Trading) Act* (Cap. 52A) also regulates “unfair practice” in the case of certain “financial services” and “financial products” and might affect a purchaser (including a bank acting as purchaser) of a consumer receivables contract.

Financial institutions which are regulated by the Monetary Authority of Singapore are required to comply with codes of conduct, notices and directives issued by the MAS in regard to their transactions with customers (including consumers).

---

**8.5 Currency Restrictions. Does Singapore have laws restricting the exchange of Singapore’s currency for other currencies or the making of payments in Singapore’s currency to persons outside the country?**

---

The *Exchange Control Act* (Cap. 99) has been suspended by the Monetary Authority of Singapore on 1 June 1978, which lifted exchange controls in Singapore.

## 9 Taxation

---

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Singapore? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

---

Withholding tax is applicable to interest on overdue trade accounts and interest on credit terms paid to a non-resident supplier. This is the case even if the interest charged on the late payment of the sale of goods is treated as part of the seller’s trade income. Where the sale of trade receivables is at an artificial discount, or where part of the purchase price is artificially payable upon collection of the receivable, there is a risk of such recharacterisation.

---

**9.2 Seller Tax Accounting. Does Singapore require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

---

There is no mandatory requirement that a specific accounting policy must be adopted for tax purposes by the seller or purchaser in the context of a securitisation.

---

**9.3 Stamp Duty, etc. Does Singapore impose stamp duty or other documentary taxes on sales of receivables?**

---

No stamp duty or other documentary tax is chargeable on the sales of receivables in Singapore.

---

**9.4 Value Added Taxes. Does Singapore impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

---

In Singapore, the *Goods and Services Tax Act* (Cap. 117A) provides for a goods and services tax on the supply of goods and services made in Singapore by a taxable person in the course of any business carried on by him; and on the importation of goods into Singapore. The sale of receivables is exempted from such tax as the sale of receivables is regarded as an exempt financial service as specified in paragraph 1 of the Fourth Schedule of the *Goods and Services Tax Act*.

---

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

---

There are no value added tax, stamp duty or other transfer taxes on the sale of receivables in Singapore.

---

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Singapore, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Singapore?**

---

The purchaser’s purchase of the receivables from obligors in Singapore, its appointment of the seller as its servicer and collection agent for such obligors in Singapore, and its enforcement of the receivables against the obligors in Singapore, may make such purchaser liable to tax in Singapore.

**Petrus Huang**

Drew & Napier LLC  
10 Collyer Quay  
#10-01 Ocean Financial Centre  
Singapore 049315  
Singapore

Tel: +65 6531 2208  
Fax: +65 6535 4906  
Email: [petrus.huang@drewnapier.com](mailto:petrus.huang@drewnapier.com)  
URL: [www.drewnapier.com](http://www.drewnapier.com)

Petrus Huang is a Director with Drew & Napier LLC's Corporate & Finance Department and is the co-Head of the Capital Markets Group. He has more than 20 years of practice experience and is highly recommended for Banking & Finance in the Global Counsel 3000, Asia Pacific Legal 500 and Practical Law Company Which Lawyer? 2011/2012 both endorse him as a leading Capital Markets lawyer. He is the editor of *CCH Annotated Singapore Stock Exchange Listing Manual* and also one of the contributors of *Halsbury's Laws of Singapore* volume on Securities Law and *LexisNexis' Annotated Business Trusts Act*. He is a member of the Disciplinary Committee of the Singapore stock exchange (SGX). He is a Director of SGX-listed Scintronix Limited. Petrus graduated in law from Cambridge University and is a holder of a Diploma (Investments) with the Institute of Banking and Finance. He is a barrister-at-law at Lincoln's Inn (London) as well as an Advocate & Solicitor of Singapore.

**Ron Cheng**

Drew & Napier LLC  
10 Collyer Quay  
#10-01 Ocean Financial Centre  
Singapore 049315  
Singapore

Tel: +65 6531 2230  
Fax: +65 6535 4906  
Email: [ron.cheng@drewnapier.com](mailto:ron.cheng@drewnapier.com)  
URL: [www.drewnapier.com](http://www.drewnapier.com)

Ron Cheng is an Associate Director with the Corporate & Finance Department of Drew & Napier LLC. Ron has practised corporate and commercial law in Singapore and Australia, handling a range of corporate matters. Ron's practice areas include mergers and acquisitions, corporate finance, private equity and funds. Ron graduated from the National University of Singapore in 2002 with Honours. He is an Advocate & Solicitor of Singapore, a Solicitor of England & Wales and a Barrister & Solicitor of Victoria.

## DREW & NAPIER LLC

Established in 1889, Drew & Napier LLC is one of Singapore's leading and largest law firms, with over 250 lawyers and fee-earners. Its regular clientele includes Singapore Government agencies, Statutory Boards and government-linked corporations as well as investment agencies. Drew & Napier LLC has market leading practices in Corporate & Finance, Competition & Antitrust, Telecommunications, Media & Technology, and Admiralty & Shipping and has been consistently rated top tier in dispute resolution over the years by international ranking organisations such as *Asia Pacific Legal 500*, *Chambers Global*, *Practical Law Company* and *Asia Law Profiles*. Drew & Napier LLC is also rated top tier in Corporate Insolvency & Restructuring, Intellectual Property and Tax. The Corporate & Finance practice group within Drew & Napier LLC is a top-tier team acting for a variety of clients in all areas of corporate practice including mergers & acquisitions, capital markets, financing and advice on regulatory, compliance and tax matters.

# Spain



Ramiro Rivera Romero



Jorge Martín Sainz

Uría Menéndez Abogados, S.L.P.

## 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

As a general rule, under Spanish law, agreements do not need to be formalised in writing. Verbal agreements and tacit agreements (those which are construed as a result of the behaviour of the parties) are, as a matter of principle and except for certain types of contracts, fully enforceable between the contracting parties. However, the difficulties of evidencing the contracting terms and conditions for verbal and tacit agreements have resulted in a generalised use of written agreements for the sale of goods and services. As a result, the Spanish Civil Code favours the written form for contracts and, though not refusing to render valid verbal agreements, does vest the parties with the right to request written form from their counterparties. Moreover, specific Spanish regulations (such as some of those protecting consumers, banking, etc.) do impose mandatory written form.

As they are not usually signed by the recipient, invoices do not *per se* create an enforceable debt obligation of the obligor to the seller. However, together with other means of evidence, they can help to prove the existence of a contract between the obligor and the seller.

**1.2 Consumer Protections. Do Spanish laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

**Limits on rates of interest:** Spanish law does not provide for a specific threshold rate beyond which interest should be generally treated as usurious (which would render the relevant loan or credit provision null). The only parameter is set out in the law of 23 July 1908, on usury, which establishes that loan agreements providing for interest rates which considerably exceed the “normal” interest rate and are manifestly excessive in view of the circumstances of the case, are null. Over the years, this law has been applied in a significant number of cases, which examine the specific circumstances surrounding each case, thus making it difficult to draw general conclusions.

Interest rate restrictions also apply in the context of certain consumer-related transactions. Credit facilities granted by credit institutions to consumers and associated with a bank account may be drawn upon in excess of the available funds. Any such overdraft must bear interest at an effective rate which cannot exceed the legal limit of 2.5 times the legal interest rate in force from time to time (the legal interest rate is regularly fixed by the government on a yearly basis). Similarly, certain public housing-related mortgages are subject to interest rate limitations or otherwise require the use of regulated criteria and formulae which result in rate restrictions.

Additionally, Royal Decree-Law 6/2012, of 9 March, on urgent measures to protect low income mortgage debtors (“**RDL 6/2012**”), establishes a voluntary adherence good practice code for credit entities and professional lenders. Once the relevant credit entity voluntarily adheres to the code (which up to this date, almost all Spanish credit entities have done), the code becomes mandatory for such credit entity.

RDL 6/2012 provides for a mandatory and temporary cap to the ordinary interest rate applicable to already existing residential mortgage loans granted for the acquisition of properties for a consideration below certain levels to individuals who evidentially fall below the exclusion threshold (as defined in Article 3 of RDL 6/2012).

**Interest on late payments:** Unless the contract between the seller and the obligor provides otherwise, the Spanish Civil Code provides that late payments trigger the obligation of the obligor to pay default interest to the seller, at the legal interest rate and calculated as from the date the seller demands payment of the relevant amount.

RDL 6/2012 also establishes a compulsory (i.e., not subject to adherence to the good practice code by the creditors) cap for default interest (ordinary interest plus 2 per cent) applicable to already existing residential mortgage loans granted to individuals who evidentially fall below the exclusion threshold (as defined in Article 3 of RDL 6/2012).

Recently, the Spanish government enacted Law 1/2013, 14 May, on measures to protect mortgage debtors, debt restructuring and social rent (“**Law 1/2013**”) which establishes the following limitations on mortgage loans that finance the acquisition of a main residence (*vivienda habitual*): (i) prohibits the compounding of late payment interest (except in certain scenarios); and (ii) establishes a cap on default interest equal to three times the legal interest rate. In this regard, the recent Directive 2014/17/EU of 4 February 2014 provides that Member States may require that, where the creditor is permitted to define and impose charges on the consumer arising from the default, those charges are no greater than is necessary to compensate the creditor for costs it has incurred as a result of the default.

**Consumer withdrawal rights:** Consumers are entitled to cancel an agreement (and therefore the receivables arising from it) if provided under the applicable sector legislation (for instance, financial and telecommunications sectors include withdrawal rights for consumers) or as agreed between the seller and the obligor-consumer. Unless a different term is provided under the applicable sector legislation, consumers are entitled to cancel the consumer agreement during a period of seven working days since the delivery of the goods or the execution of the service agreement (as the case may be), provided that the seller duly informed the obligor-consumer of the existence and characteristics of the withdrawal right (otherwise, the term would be seven working days since the information obligations have been duly fulfilled, up to a maximum of three months from the delivery of the goods or the execution of the service agreement).

When it comes specifically to consumer financing, Spanish Act 16/2011, of 25 June, on consumer finance (“**Act 16/2011**”), which implements Directive 2008/48/EC, of 23 April, provides for a withdrawal right in favour of the obligor-consumer (who can trigger it for any reason) for a period of 14 calendar days as from the later of the following dates: (i) the date when the credit agreement is executed; and (ii) the date of delivery of certain financial information and terms by the credit institution to the consumer. Where the consumer elects to exercise its withdrawal right, the creditor will not be entitled to any compensation other than payment of the capital and interest accrued from drawdown of the credit until full repayment.

On a similar note, Spanish Act 22/2007, of 11 July, on distance marketing of financial services to consumers, establishes a similar 14 calendar-days’ withdrawal right.

**Other noteworthy rights:** Law 1/2013 provides for a two-year moratorium until 15 May 2015 for the eviction (in the context of mortgage loan foreclosure procedures) from a main residence (*vivienda habitual*) of any individuals who evidentially fall below the exclusion threshold and economic circumstances established in Law 1/2013.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

Royal Legislative-Decree 3/2011, of 14 November (“**Act 3/2011**”), on public sector contracts, provides for the legal regime applicable to agreements entered into by the majority of public entities (which would include the general, regional or local administrations, but also public-owned or public-controlled entities, such as *organismos autónomos*, *entidades públicas empresariales* and *empresas públicas*) and third parties. Specific provisions are provided therein for the sale and collection of receivables.

That said, the legal regime applicable to the sale of receivables arising out of agreements subject to Act 3/2011 is, in substance, equivalent to the general regime provided under the Spanish Civil Code (which will be described below), including, in particular, the need to notify the obligor in order for the assignment to be fully effective against the obligor. The collection of receivables against public entities is subject to customary procedures followed by public entities (e.g. the need to have budgetary support for any agreed payment, applicable sovereign immunity principles, etc.), and is usually based on the issuance of payment mandates by the relevant entity. Act 3/2011 and other regulations on the payment of business receivables impose strict payment terms of the Spanish public administrations and entities, including very onerous late payment interest duties.

**2 Choice of Law - Receivables Contracts**

**2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Spain that will determine the governing law of the contract?**

Under 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) (“**Regulation 593/2008**”), which is directly applicable in Spain, to the extent that the law applicable to the contract has not been chosen by the parties, the law governing the contract shall be, in principle, determined in light of the nature of the agreement. Pursuant to paragraphs (a) and (b) of Article 4.1 of Regulation 593/2008, the law governing the contracts for the sale of goods or the provision of services would be, in principle, the law of the country where the seller or provider of services has its habitual place of residence. That said, if it is clear from all the circumstances of the case at hand that the contract is manifestly more closely connected with a country other than that resulting from the application of Article 4.1 of Regulation 593/2008, the law of that other country applies.

However, where the contract for the sale of goods or the provision of services is entered into with obligors qualifying as consumers, it will be governed by the law of the country where the consumer has his/her habitual place of residence, provided that the professional (a) pursues its commercial or professional activities in the country where the consumer has his/her habitual place of residence, or (b) by any means, directs such activities to that country or to several countries including that country, and the contract falls within the scope of such activities.

**2.2 Base Case. If the seller and the obligor are both resident in Spain, and the transactions giving rise to the receivables and the payment of the receivables take place in Spain, and the seller and the obligor choose the law of Spain to govern the receivables contract, is there any reason why a court in Spain would not give effect to their choice of law?**

No, there is not.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Spain but the obligor is not, or if the obligor is resident in Spain but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Spain give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

Yes, pursuant to the freedom of choice principle established by Article 3 of Regulation 593/2008.

However, the application of the Spanish overriding mandatory provisions (i.e., those provisions the respect for which is regarded as crucial by Spain to safeguard its public interests, such as its political, social or economic organisation) shall not be limited. Furthermore, Spanish courts may refuse the application of a provision of the chosen law if it is manifestly incompatible with Spanish public policy. Finally, if the chosen law is not from a EU Member State and all elements relevant to the situation at the time

of the choice of law are located in one or more Member States, the parties' choice of law shall not prejudice the application of the provisions of EU law which cannot be derogated by agreement.

None of these limitations would typically apply in commercial relationships such as that between the seller and the obligor under a receivables contract.

## 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Spain?

Yes, it is in force in Spain as from 1 August 1991.

## 3 Choice of Law - Receivables Purchase Agreement

### 3.1 Base Case. Does Spanish law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Spanish laws or foreign laws)?

Pursuant to the freedom of choice principle established by Articles 3 and 14 of Regulation 593/2008, the sale of receivables can be governed by a law different from that governing the receivable itself. This notwithstanding, where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties will not prejudice the application of provisions of the law of that other country which cannot be derogated by agreement (i.e., the so-called "mandatory provisions").

Moreover, Article 14.2 of Regulation 593/2008 establishes that the law governing the receivable must determine: (i) its transferability; (ii) the relationship between the assignee and the debtor; (iii) the conditions under which the assignment can be invoked against the debtor; and (iv) whether the debtor's obligations have been discharged.

Likewise, some of the rights and obligations arising under promissory notes, bills of exchange and other types of negotiable instruments executed and delivered in Spain may not be submitted to the laws of a different country.

Where the obligations arising under the receivables are secured by security interests on Spanish assets (for instance, a mortgage on real estate located in Spain), mandatory Spanish laws will apply to any such right *in rem*, and will govern, *inter alia*, the perfection and foreclosure of the security interest as well as the assignment thereof for the benefit of third parties.

### 3.2 Example 1: If (a) the seller and the obligor are located in Spain, (b) the receivable is governed by the law of Spain, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Spain to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Spain, will a court in Spain recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Pursuant to Articles 3 and 14 of Regulation 593/2008, Spanish law would be, in principle, the law governing the contractual aspects of the sale agreement, as well as the conditions under which the assignment can be invoked against the obligor in this Example 1

(please refer to question 3.1). Thus, if the sale meets the Spanish legal requirements for such purposes (please refer to questions 4.1 and 4.4), a Spanish court would recognise the sale as being effective against the seller and the obligor.

However, Regulation 593/2008 fails to regulate which law should be considered to determine whether the transfer of the receivables is effective *vis-à-vis* third parties (in fact, Article 27.2 of Regulation 593/2008 refers to a report to be prepared by the Commission on this topic as the basis for the amendment of Regulation 593/2008).

Accordingly, key questions such as the effectiveness of an assignment against third parties (by way of example, in the context of a Spanish law insolvency of the seller), and the priority of the assigned receivable over a right of another person (for instance, in case an attachment or some other form of seizure or charge was sought to be levied upon the seller by another creditor), have not been resolved under Regulation 593/2008, and therefore remain subject to legal controversy and dispute. Under Spanish law, there is not yet an agreed and widely applied rule resolving this situation, but there is already a clear reference in the local law implementing the EC Financial Collateral Directive (Royal Legislative-Decree 5/2005, dated 11 March – "RDL 5/2005"), which specifically provides (Article 17.3 of RDL 5/2005) that where an assignment of credit rights has been used as financial collateral, the effectiveness of such assignment against the debtor and third parties shall be ruled by the law governing the assigned receivable. This principle has been generally regarded by the majority of Spanish legal authors as the rule that should apply across all cases where a credit right is assigned by way of security or pledged, and also, and by extension, to any other form of ordinary assignments.

Having said that, taking into account the circumstances of Example 1 (all connected to Spain except for the location of the purchaser), the different solutions on this matter proposed by Spanish scholars in the past and the discussions in the context of the preparation of Regulation 593/2008, it is likely that a Spanish court would recognise the sale as being effective *vis-à-vis* third parties if the sale complies with the Spanish legal requirements for such purposes (please refer to question 4.2).

### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Spain, will a court in Spain recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

Please refer to questions 3.1 and 3.2 as to the law applicable to contractual aspects of the assignment, the conditions under which the assignment can be invoked against the obligor and the enforceability of the transfer *vis-à-vis* third parties.

If the sale meets the Spanish legal requirements for such purposes (please refer to questions 4.1 and 4.4), a Spanish court would recognise the sale as being enforceable against the seller and the obligor.

However, the fact that the obligor is located in a jurisdiction other than Spain (and in absence of additional development of the provisions of Regulation 593/2008) would make generally advisable the fulfilment of the legal requirements for purposes of enforceability of the transfer *vis-à-vis* third parties both under Spanish law and under the law of the location of the obligor, in order to ensure recognition by Spanish and the obligor's country courts.



**3.4 Example 3:** If (a) the seller is located in Spain but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Spain recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Spanish own sale requirements?

Please refer to questions 3.1 and 3.2 as to the law applicable to contractual aspects of the assignment, the conditions under which the assignment can be invoked against the obligor, and the enforceability of the transfer *vis-à-vis* third parties.

Thus, if the sale complies with the foreign legal requirements for such purposes, a Spanish court would recognise the sale as being effective against the seller (such requirements and foreign law would need to be duly evidenced to the Spanish court).

However, the fact that the seller is located in Spain (and in absence of additional development of the provisions of Regulation 593/2008) would make generally advisable the fulfilment of the legal requirements for purposes of enforceability of the transfer *vis-à-vis* third parties both under Spanish law and under the law of the location of the obligor, in order to ensure recognition by Spanish courts.

**3.5 Example 4:** If (a) the obligor is located in Spain but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Spain recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Spanish own sale requirements?

Please refer to questions 3.1 and 3.2 as to the law applicable to contractual aspects of the assignment, the conditions under which the assignment can be invoked against the obligor, and the enforceability of the transfer *vis-à-vis* third parties.

Thus, if the sale complies with the foreign legal requirements for such purposes, a Spanish court would recognise the sale as being effective against the obligor (such requirements and foreign law would need to be duly evidenced to the Spanish court).

However, the fact that the obligor is located in Spain (and in absence of additional development of the provisions of Regulation 593/2008) would make generally advisable the fulfilment of the legal requirements for purposes of enforceability of the transfer *vis-à-vis* third parties both under Spanish law under the foreign law, in order to ensure recognition by Spanish courts.

**3.6 Example 5:** If (a) the seller is located in Spain (irrespective of the obligor's location), (b) the receivable is governed by the law of Spain, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Spain recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Spain and any third party creditor or insolvency administrator of any such obligor)?

Please refer to questions 3.1 and 3.2 as to the law applicable to contractual aspects of the assignment, the conditions under which the assignment can be invoked against the obligor, and the enforceability of the transfer *vis-à-vis* third parties.

Thus, if the sale complies with the foreign legal requirements for such purposes, a Spanish court would recognise the sale as being effective against the seller (such requirements and foreign law would need to be duly evidenced to the Spanish court).

However, as the seller is located in Spain and the receivable is governed by Spanish law (and in absence of additional development of the provisions of Regulation 593/2008), it would be generally advisable that the legal requirements for purposes of enforceability of the transfer *vis-à-vis* third parties, both under Spanish law and under the foreign law, are fulfilled, in order to ensure recognition by Spanish courts.

## 4 Asset Sales

**4.1 Sale Methods Generally.** In Spain what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

Under Spanish law, receivables may be transferred from a seller to a purchaser in the following different ways, all of which involve the execution of an agreement providing for the transfer of the receivable to the purchaser:

- ordinary assignment pursuant to the Spanish Commercial and Civil Codes;
- assignment pursuant to the Third Additional Provision of Law 1/1999, of 5 January, on Capital-Risk Entities; and
- assignment to a Spanish Asset-Backed Securitisation Fund (*Fondo de Titulización de Activos*, hereinafter "FTA").

Although there is no common terminology, the above transactions will be customarily referred to as transfers of receivables (*cesiones de crédito*).

**1. Ordinary assignment.** Under the Spanish Commercial and Civil Codes, the seller remains liable before the purchaser for the existence of the receivable and for the validity of its legal title over it, but it is not liable for the insolvency of the debtor, unless so agreed with the purchaser. It is thus possible to agree on sales with or without recourse, though in the absence of a specific provision thereon, there will be no recourse against the seller.

**2. Privileged assignment.** In accordance with the Third Additional Provision of Law 1/1999, a specific and more beneficial insolvency-related regime (please refer to question 6.3) applies to assignments of credits which, though generally structured as ordinary assignments, fulfil the following requirements:

- (a) the seller is a business company (or an entrepreneur) and the receivables arise from its business activity;
- (b) the assignee is a credit entity or a securitisation fund;
- (c) the receivables exist at the time of the execution of the receivables transfer agreement. However, the sale of “future” receivables is also allowed, provided that those receivables arise from the business activity of the seller within a maximum term of one year from the date of execution of the agreement or, otherwise, the future debtors are clearly identified in the agreement;
- (d) the assignee pays to the seller, either upon closing or on a deferred basis, the consideration agreed for the receivables, excluding the costs of the services rendered (i.e., financing, collection, etc.); and
- (e) where the assignment is agreed on a non-recourse basis, there is evidence that the purchaser has paid, in full or in part, the consideration for the receivables prior to their maturity.

3. **FTA.** According to Royal Decree 926/1998, of 14 May, on Asset-Backed Securitisation Funds, additional requirements apply to ordinary assignments made in favour of FTA, a form of regulated securitisation SPV which, subject to local registration, is allowed to issue asset-backed notes under insolvency-related privileged conditions (please refer to question 6.3). These requirements include the following, among others:

- (a) the transfer of receivables must be agreed on a non-recourse basis to the seller, subject to no conditions, and for the remaining maturity of the receivables; and
- (b) the seller cannot grant any kind of warranty (*garantía*) in favour of the purchaser nor guarantee the success of the transaction (*asegurar el buen fin de la operación*). Notwithstanding this, it is customary to agree on certain limited representations and warranties in order to ensure that the securitised portfolio conforms to the agreed eligibility criteria.

In relation to the above, it is worth mentioning that the Spanish Government has proposed a draft law to foster company funding – *Ley de Fomento de la Financiación Empresarial* – (the “**Draft Law to Foster Company Funding**” or the “**Draft Law**”), which is expected to set up a new Spanish securitisation regime.

Finally, it is also important to mention that in 2012 legislation on the restructuring of the Spanish bank system entered into force (Act 9/2012, of 14 November and Royal Decree 1559/2012, of 15 November) which has implemented a privileged regime for the sale of assets – including receivables – from the *Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria* – Asset Management Company for Bank Restructurings – (“**Sareb**”) to *Fondos de Activos Bancarios* – Banking Asset-Backed Fund – (“**FABs**”).

Sareb is an asset management company with combined public and private ownership that acquired the troubled assets from the four Spanish financial entities nationalised at the time and from four other financial institutions that were subject to a restructuring process pursuant to the legislation mentioned in the preceding paragraph. FABs are special purpose vehicles designed to acquire assets or liabilities from the Sareb under a beneficial tax regime.

---

#### 4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

---

There are no special formalities for an ordinary or privileged sale of

receivables (or for a sale to a FTA) to be effective between the contracting parties, though (a) the written form is customary, and (b) where the receivables result from a contract agreed in a public document, the parties may legally require that the assignment be also executed in a public document (though failure to do so does not affect the validity of the transfer between the contracting parties).

Nevertheless, under Articles 1218, 1227 and 1526 of the Spanish Civil Code, certainty of the date of the transfer is required for it to be fully effective *vis-à-vis* third parties (for instance, in order to ensure that true sale treatment is achieved, or for insolvency protection purposes). This certainty of the date of the transfer may be achieved, *inter alia*, by formalising the transfer in a public deed (*escritura pública* or *póliza intervenida*) before a Spanish Notary Public.

---

#### 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

---

1. **Payment instruments.** Receivables represented by bills of exchange (*letras de cambio*), promissory notes (*pagarés*) and other analogous securities supporting abstract means of payment (*efectos cambiarios*) may be transferred by means of the physical delivery of the security document, followed (in the case of negotiable bills of exchange and registered promissory notes) by an endorsement, that is, a written and signed transfer statement issued by the seller in the title itself. Such means of transfer results in a full transfer of all rights attached to the relevant *efecto cambiario*, though not necessarily in a full transfer of the underlying receivable.

The issuance and transfer of *efectos cambiarios* is regulated by a special law, is specifically excluded from the application of Regulation 593/2008 and may entail the accrual of stamp duty (please refer to question 9.3).

2. **Mortgage loans.** The transfer of a single mortgage loan needs to be documented in a public document and registered with the relevant Land Registry. Otherwise, the transfer will be valid amongst the parties, but will not be effective *vis-à-vis* third parties and the foreclosure procedure may be severely limited. Similar requirements apply to the transfer of receivables secured with a chattel mortgage (*hipoteca mobiliaria*) or a pledge without displacement of possession (*prenda sin desplazamiento de posesión*), except that registration is filed before the relevant movable assets registry (*Registro de Bienes Muebles*). All the aforesaid transfers will generally involve the accrual of stamp duty, as the transfer is commonly documented in a public deed – *escritura pública* – that could potentially be filed with a Spanish public registry (except for pledges without displacement of possession that are normally documented in a *póliza* and thus do not accrue stamp duty).

The transfer by credit entities of their rights/interests under mortgage loans meeting the eligibility criteria set forth in Section 2 of Law 2/1981, of 25 March, on the Mortgage Market, can be also perfected issuing mortgage certificates – *participaciones hipotecarias* – (hereinafter, “**PHs**”). Such eligibility criteria require, among others, compliance with the following conditions:

- The main purpose of the loan must be the construction, renovation or acquisition of real estate assets.
- The mortgage must be a first ranking mortgage.
- The mortgaged asset cannot qualify as an “excluded” or “restricted” asset (such as, among others, usufruct or surface rights, or administrative concessions).
- The mortgaged asset must be appraised and insured for the full appraisal value.

- The LTV must be below 80 per cent in case of residential mortgages, and 60 per cent in case of commercial mortgages.

Where these Spanish mortgage loans fail to meet any of those criteria and provided that the purchaser is a qualified investor (any company with total assets over EUR 20 million and equity over EUR 2 million being considered as a qualified investor, among others) or an FTA, the transfer by credit entities of their rights/interests under said mortgage loan may be perfected by the issuance of mortgage conveyance documents – *certificados de transmisión de hipoteca* – (hereinafter, “CTHs”). PHs and CTHs qualify as transferable securities.

In addition to a more favourable insolvency regime, the main advantage of this means of transfer of mortgage loans is that, under certain conditions, the issue of both PHs and CTHs needs not be documented in a public deed (*escritura pública*) or registered in the relevant Property Registries. They also benefit from a more favourable tax regime, as no stamp duty applies.

In any event, the seller/issuer of the PHs and CTHs remains as lender of record of the underlying loans in the relevant Land Registry, but the holder of the PHs and CTHs becomes the beneficial owner of the underlying mortgage loans, subject to certain conditions that confer upon the transfer the “true sale” treatment.

Furthermore, the issuer of a PH/CTH retains by law the custody and management of the underlying mortgage loan, and is obliged to transfer to the holder of the PH/CTH any funds received from the underlying debtor, whether as principal or interest. That notwithstanding, the subscriber of a PH/CTH holds certain limited faculties also by law, such as claiming to the issuer any unpaid amounts under the PH/CTH (except if resulting from the underlying debtor’s default), or in case of default of the debtor, compelling the issuer to initiate the mortgage foreclosure proceedings, or even appearing in or commencing the mortgage foreclosure proceedings under certain circumstances.

**3. Consumer loans.** No special requirements apply to the sale of receivables when the obligors are consumers. However, Article 31 of Act 16/2011 requires that notice of the transfer is served on the consumer, where the seller ceases to provide servicing.

**4. Debt securities.** In addition to the assignment contract, those securities represented in book-entry form shall be transferred through an accounting record transfer. Those securities represented in registered form shall be transferred through the endorsement of the relevant title or under an ordinary assignment of receivables. Finally, those securities represented in bearer form shall be transferred by physical delivery of the title.

---

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?**

---

Unless otherwise stated in the receivables contracts, consent of the obligors is not required for the sale of receivables to be effective against the obligor.

The parties may or may not serve notice of the sale on the obligor. If they choose not to do it, the obligor will be allowed to validly discharge its obligations by paying the seller (as original creditor). Likewise, the legal regime applicable to the obligor’s rights to challenge or oppose payment demands under the receivable varies depending on the date of the transfer and the date when transfer notice is served (for instance, the debtor’s right of set-off will apply to those seller obligations arising prior to the transfer notice, but not to those arising afterwards, unless the debtor explicitly approves the transfer). Accordingly, failure or delay in serving notice on the debtor may result in an increased number of valid objections against any payment demand filed under the transferred receivable.

If the receivables contract prohibits assignment or requires the consent of the obligor and this is not obtained, many Spanish scholars maintain that the sale contract will remain valid amongst the parties to the sale agreement as a source of indemnity obligations, but will not be enforceable against the assigned obligors. Thus the receivables shall not be deemed transferred by the seller, who shall remain as the owner of the receivables. However, other scholars believe that the transfer of the receivables would be valid and enforceable against the obligor, who will be entitled to claim damages from the seller for the contractual breach. Spanish courts have failed to reach a definitive conclusion on this matter.

---

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

---

There are no formal requirements regarding notification to the obligor, thus it may be made by any means, by the seller or the purchaser. However, it is generally recommended: (a) to notify by any means that may later on be regarded as proof in court (i.e., *notarial acta de notificación* or certified mail with acknowledgment of receipt); and (b) to have the notice served by the seller.

No limitations apply regarding the purchaser notifying the obligor of the sale of receivables even after the insolvency of the seller or the obligor, without prejudice to the effects of the lack of notice in terms of discharge of the obligor and the obligor’s defences as set out in question 4.4, which will apply while notice of the transfer is not served.

---

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that “None of the [seller’s] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]” be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says “This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]” (i.e., the restriction does not refer to rights or obligations)?**

---

Please see question 4.4.

**4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Spain? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Spain recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Please see question 4.4.

**4.8 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

There are no specific identification requirements applicable for the transfer of receivables, but generally stem from Spanish law principles which expect the parties to be able to identify the subject-matter of any contract executed between them. Accordingly, no specific details need to be provided, other than those which enable the parties to identify, in clear and indisputable terms, the transferred receivables.

Where the receivables are to be transferred to an FTA, the rules require that the parties define the securitised assets (legally and financially) and provide details on matters such as outstanding balances, yields, financial flows, collection terms, amortisation schedule and maturity dates. Additionally, FTA's regulations provide that assets to be transferred to an FTA must be of homogeneous nature. The interpretation of homogeneous nature is not completely clear and is analysed on a case-by-case basis by the *Comisión Nacional del Mercado de Valores* ("CNMV"). This homogeneous nature requirement does not apply to Private Funds (as this term is defined below).

Transactions where all existing receivables (or all receivables fulfilling certain conditions) are sold to the purchaser are generally valid under Spanish law but may face difficulties where it is necessary to prove effectiveness *vis-à-vis* third parties, as the above referred rules on identification apply as well. The same identification difficulties will apply to the sale of all the receivables of an entity other than the receivables owing by one or more specifically identified obligors.

**4.9 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

Under Spanish law, contracts are to be interpreted not on the basis

of the name or character that the parties wish to attribute to them (for instance, in the name or the headings of the different clauses), but rather on the basis of the actual legal nature of the terms and conditions agreed thereunder. Thus, if the parties regard a transaction (for instance, by using that term in the headings or in the contents) as an assignment or other form of "true sale", but the terms and conditions thereof and, in particular, its real intent (*causa*), suggest otherwise (for instance, a form of security), a court is allowed to recharacterise the transaction as per its genuine nature.

Generally the courts have upheld the true sale treatment of the sale of receivables, regardless of the parties agreeing to such transfer on a recourse or non-recourse basis, but always provided that the purchaser advances all or part of the funds agreed as consideration for the transfer of the receivable (in other words, where such transfer is agreed in terms such that the acquirer does not advance any funds, does not bear the risk of the receivable, and is thus only used for collection purposes, the transfer shall not be treated as a true sale). This having been said, in the past, in conferring true sale treatment to any given transfer, the fact that the seller may have retained credit risk (e.g., by representing the solvency of the debtor) has occasionally been construed by the courts (for instance, in certain minority rulings on factoring agreements entered into by credit institutions) as evidence that the transfer ought not to be treated as a sale, but rather as a collateralised loan granted by the purchaser.

The fact that the parties agree to vest upon the seller collection responsibilities does not alter the above views (by way of example, where the purchaser of the receivables is an FTA, collection responsibilities shall be retained by the seller unless otherwise agreed).

In addition to the above, legal characterisation or the effect of a particular transaction is not necessarily coincident with its treatment under other conditions. For instance, Spanish accounting and capital adequacy rules applicable to credit entities focus on certain terms of the transaction (mainly credit risk retention) to determine whether a sale of receivables can benefit from off-balance sheet treatment.

**4.10 Continuous Sales of Receivables.** Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes, though the effectiveness *vis-à-vis* third parties depends on the need to provide proper identification, as well as execute a public document each time new receivables are transferred. However, the efficacy of this commitment in an insolvency scenario may be restricted in several ways.

**4.11 Future Receivables.** Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?

1. **Ordinary assignment.** Although it is generally accepted that the transfer of future receivables may be validly agreed upon by means of an ordinary assignment, scholars and case law have failed to reach a common view on whether the acceptance by the purchaser (or any other formal requirement, such as the notice to the debtor) upon each receivable effectively coming into existence is necessary

(thus casting a shadow of doubt on the efficacy of any such transfer until such time), or whether the purchaser is *ab initio* the owner of such receivables from the moment they arise. It is thus advisable to ensure that periodic transfers are executed in public documents.

**2. Privileged assignment.** The transfer of future receivables is allowed, provided that the receivables arise from the business activity of the seller within a maximum term of one year from the date when the agreement is executed or, otherwise, the future debtors are clearly identified in the agreement (please refer to question 4.1).

**3. FTA.** Existing FTA regulations allow the securitisation of future receivables to the extent, amongst other requirements, that they generate a flow of income of an already known or estimated amount. Among the types of future receivables which are eligible for such a transfer, the FTA regulations include lease rentals, flows arising out of toll road projects, flows resulting from public concession contracts, IP rights, etc. Pursuant to Order EHA/3536/2005, of 10 November, the transfer of future receivables in favour of an FTA must meet the following requirements: (i) the transfer is full and unconditional (*plena e incondicionada*); and (ii) the incorporation deed of the FTA includes (a) the terms of the agreement or activity which will generate the future receivables, (b) the powers of the seller over those future receivables transferred, (c) the terms and conditions of the transfer, and (d) the risk allocation between the seller and the purchaser of the receivables.

Please refer to questions 6.1 and 6.5 on the treatment of receivables arising prior to, or after, the declaration of insolvency.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

In general, the sale of a receivable entails the automatic transfer of all accessory rights to such receivable, such as personal guarantees (*fianzas*), pledges, mortgages or other privileges (unless otherwise agreed by the relevant guarantor). However, please refer to question 4.3 as to the specific conditions for the sale of mortgage loans. Furthermore, for the transfer of security to be effective *vis-à-vis* the guarantor, notice should be served. Similarly, the terms of the accessory rights should be reviewed as they may provide for additional requirements.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

The Spanish Civil Code establishes a general set-off right between parties when, among other requirements, two entities are reciprocally principal debtor and principal creditor of each other and the amounts are due, liquid and payable.

In case the obligor consents to the assignment, the obligor may not oppose before the purchaser any set-off rights that it may have with the seller. If on the contrary, the obligor did not approve the assignment but was notified of the assignment, it may claim against

the purchaser any former set-off rights that it may have had before it received such notice. However, subsequent set-off rights against the seller arising after notice is served will not be valid.

Consequently, if the assignment is not notified, the obligor will be entitled to oppose before the purchaser any set-off rights that it may have against the seller arising before and after such assignment.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Spain to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

Such practice is not customary in Spain.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Spain, and for such security interest to be perfected?**

Receivables can be subject to an ordinary pledge, a pledge without displacement of possession, or a financial guarantee. Spanish national legal regime (described below) applies generally to these securities but, depending on where the pledged object is located, regional regulations may also apply.

The benefit of a security interest perfected over a receivable will also extend to any related security (please refer to question 4.12). In addition, under certain limited circumstances, additional security interests may be perfected over existing security interests (e.g., perfecting a mortgage over a pre-existing mortgage or perfecting a pledge over the rights stemming from a pre-existing pledge or a personal guarantee – *fianza*).

**1. Ordinary pledge.** A "displacement of the possession" of the pledged asset is required for the pledge to be valid. Although it is not clear how this dispossession requirement is to be interpreted when the object of the pledge is a receivable (i.e., an intangible asset), some scholars understand that displacement of possession is effected through the notice to the debtor, while others (as well as Spanish insolvency rules) maintain that the mere agreement of the parties is sufficient for validity purposes, with no need to notify the obligor.

In order to ensure that the ordinary pledge is enforceable *vis-à-vis* the obligor and any other third party, the pledge must be executed in a public document (*escritura pública or póliza intervenida*). The pledge shall not be registered in any public registry. However, in case of insolvency of the pledgor, the special privilege for claims secured with ordinary pledges and generated after the insolvency declaration is subject to discussion following an amendment to the Spanish insolvency law in October 2011. The aforesaid amendment has been, for most scholars, very controversial and its interpretation should be clarified by further case law (since the few lower court rulings released so far have failed to reach a common interpretation).

**2. Pledge without displacement of possession.** In order for the pledge without displacement of possession to be valid, it must be duly registered with the relevant movable assets registry (*Registro de Bienes Muebles*) and must be executed in a public document (*escritura pública or póliza intervenida*). In practice, this type of pledge is documented in a *póliza* in order to avoid certain tax costs (please refer to question 4.3); they are becoming increasingly used as they benefit from a more certain insolvency treatment than

ordinary pledges (following the aforesaid amendment to the Spanish insolvency regime in October 2011).

**3. Financial guarantees.** Following a reform of the Spanish legal regime applicable to financial guarantees (i.e., those resulting from the implementation in Spain of Directive 2002/47/EC, of 6 June, on financial guarantees), certain receivables held by credit institutions may be the object of financial guarantees in the form of pledge or *repos* (such securities benefiting from the privileged legal regime applicable to financial guarantees in terms of, *inter alia*, perfection, enforcement and insolvency).

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Spain to grant and perfect a security interest in purchased receivables governed by the laws of Spain and the related security?**

Please refer to question 5.2.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Spain, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Spain or must additional steps be taken in Spain?**

As per Article 14.3 of Regulation 593/2008 (please refer to question 3.4), the principles set out in this rule are expected to apply to any form of assignment by way of collateral. Accordingly, the concept of “assignment” includes “*not only outright transfers of claims, (but also) transfers of claims by way of security and pledges or other security rights over claims*”.

Generally speaking, provided that the applicable conflict of law rules are complied with, the granting of a security interest under a foreign law would be treated as valid and perfected in Spain.

As mentioned above, Regulation 593/2008 leaves open the question of the enforceability of the sale *vis-à-vis* third parties (see Article 27(2)). It is therefore not fully clear which law should govern the effectiveness of a pledge of receivables against other creditors of the seller, insolvency administrators or even third parties alleging a preferential legal title on the relevant pledged receivables. In the meantime, it is generally advisable that, when enforceability of a pledge *vis-à-vis* third parties is expected to be sought before a Spanish court (for instance, in the context of an insolvency of a Spanish-based pledgor or where the obligor is located in Spain), Spanish law perfection requirements be met as well. Under Spanish law, a security interest over receivables (either formalised as an ordinary pledge, as a pledge without displacement or a financial guarantee) is generally a right *in rem*. Spanish Civil Code provides that rights *in rem* over assets located in Spain must be governed by Spanish law. Location of receivables is not a clear-cut issue, but to the extent that receivables are deemed located in the country of the law governing the receivable, or where the seller or obligor operate, and the country of the purchaser is different from those, Spanish courts may refuse enforcement of the pledge, even if the requirements for the validity and perfection of the security interest have been followed.

Notwithstanding the above, it must be noted that Spanish regulations implementing Directive 2002/47/EC, of 6 June, on financial guarantees (i.e., RDL 5/2005) have been amended and now expressly provide that, when the object of the financial guarantee is receivables (please refer to question 5.2), the law

governing the enforceability of the financial guarantee *vis-à-vis* third parties shall be the law governing the underlying receivable which is the object of the guarantee. Although it is true that this provision refers to a very specific security interest, it cannot be discarded that Spanish courts make, in the absence of any other Spanish or EU legal provision on this matter, an analogous interpretation of this rule and apply it to other types of security interest over receivables, and even to the enforceability of receivables transfers *vis-à-vis* third parties.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

In addition to those requirements set forth in question 5.2, the granting of security interests on each of those assets require the following:

**1. Mortgage loans.** Under Spanish law, the creditor in a mortgage loan may grant an additional mortgage on its right of credit (the so-called “mortgage on the mortgage” or “sub-mortgage”). This mortgage must be executed in a public deed and be registered with the relevant public registry.

**2. Promissory notes and marketable debt securities.** Where those securities have been represented in book entry form, the creation of a pledge needs to be registered with the relevant registry to ensure effectiveness *vis-à-vis* third parties. If the securities have been issued in registered form, the securities must be delivered to the beneficiary-pledgee and the pledge needs to be registered in the relevant certificate by way of an “endorsement for guarantee purposes”. If the securities have been issued in bearer form, the securities must be delivered to the beneficiary-pledgee.

**3. Insurance policies.** No specific requirements are applicable for the granting of security interest over rights arising out of insurance policies, except that, pursuant to Article 99 of the Spanish Insurance Contract Law, notice to the insurance company is required and no assignment is allowed in life insurance policies where a beneficiary has been designated on an irrevocable basis. However, in case of creation of any security interest over assets which are insured against damages, the scope of the security must extend to the indemnities recovered by the insured party as a consequence of an insured event (for such purpose, the insurance company must be served notice of the creation of the security).

**5.6 Trusts. Does Spain recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

The concept of “trust” is not one which is regulated and/or fully recognised (i.e., generally accepted by Spanish courts) under Spanish law and practice. It is therefore not usual to find trusts used as a means to ensure that flows resulting from the assigned receivable and temporarily held by the seller are kept legally isolated from the rest of the seller’s assets. However, similar effects may be achieved through a pledge over the bank account where the collections received by the seller are credited, securing the seller’s obligations *vis-à-vis* the purchaser. Such a pledge would in principle create a special privilege in favour of the purchaser over the balance of the account, either in an insolvency or non-insolvency situation (although claims of the purchaser arising after the insolvency declaration might face difficulties to be recognised

as privileged claims in light of the current regulations). Moreover, special arrangements with the credit entity where the account is opened could be implemented so that, upon the occurrence of a specified insolvency event affecting the seller, disposal instructions need to be received from the purchaser.

**5.7 Bank Accounts. Does Spain recognise escrow accounts? Can security be taken over a bank account located in Spain? If so, what is the typical method? Would courts in Spain recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Spain?**

Bank accounts opened in the name of a given party, but where disposal by its holder is limited, blocked or otherwise conditioned to the occurrence of a specific event, the consent or instructions of a third party or any other circumstance, are legally admissible and are market practice under Spanish law. Moreover, security can be taken over receivables arising out of a bank account located in Spain, through an ordinary pledge or a pledge without displacement (please refer to question 5.2 for further information on these types of securities). Pledges over bank accounts can benefit from a specific privileged regime (especially when it comes to enforcement and in the event of seller's insolvency) if certain conditions in relation to the nature of the parties to the pledge and the secured obligations are met.

In cases where a bank account is located in Spain (i.e., it is opened in a Spanish office of a credit entity), receivables deriving thereunder shall most likely be understood as located in Spain and, as a result, Spanish courts may refuse enforcement of a foreign law pledge which has not been perfected as per applicable Spanish rules (please refer to question 5.4 above on more details on this issue).

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

If a pledge over the balance of a bank account from time to time has been created, the secured party will generally be entitled to appropriate such balance as per the enforcement rules agreed. If the bank account is held in the same bank which is secured by such pledge, the secured creditor will generally have the right to set-off.

The enforcement of these pledges following an insolvency declaration may face other restrictions.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Yes, if the security has not been enforced, the parties may agree on a regime allowing the restricted or even unlimited use of the funds by the debtor. That said, it is not unusual to establish a symbolic minimum amount that must remain at all times, on the bank account (so that the balance is always positive), since some scholars argue that if the balance of the bank account is zero or negative at any time (and thus no credit derives from the bank account – i.e., there is no object for the pledge), the security could be interpreted as automatically cancelled.

Additionally it is contractually possible to limit the faculties of the holder of the bank account over it, either from the execution of the pledge or following a specific event (i.e., an event of default), although an amendment of the bank account agreement (and therefore, consent from the depositary bank) would be needed.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Spanish insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

**Sale of receivables.** No stay of action would be applicable under Spanish insolvency regulations. Where the transferred receivables have been properly identified, the purchaser should be allowed to continue collecting and exercising ownership rights over the transferred receivable. If not done already, the purchaser is allowed to serve notice of transfer on the obligors. Additional transfers (e.g., in the context of a sale of future receivables or a continuous sale of receivables) may be delayed or even suspended. Any funds collected from the receivables by the seller on behalf of the purchaser, which have not been transferred to the purchaser, may be subject to insolvency proceedings (commingling risk).

As a matter of practice, though, where administration of receivables is still being conducted by the seller (and therefore some acts by the seller are necessary so that the purchaser may continue to collect the receivables), it cannot be discarded that the insolvency officials dispute the need to continue serving the receivables and/or that specific arrangements are put in place to allow collection funds to be paid out of the insolvency proceedings.

**Pledge of receivables.** Unless the foreclosure proceedings have reached certain stages before the insolvency proceedings have started, the enforcement of security interests over assets owned by the seller and used for its professional or business activities will be stayed following the declaration of insolvency until the first of the following circumstances occurs: (a) approval of a creditors' composition agreement (unless the content has been approved by the favourable vote of the purchaser as secured creditor, in which case it will be bound by the composition agreement); or (b) one year has elapsed since the declaration of insolvency without liquidation proceedings being initiated.

There is general controversy about whether a pledge on a portfolio of receivables would qualify as a security on assets “used for its professional or business activities”.

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

Please refer to question 6.1.

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Spain for (a) transactions between unrelated parties, and (b) transactions between related parties?**

Pursuant to the general regime set forth under the Spanish insolvency law, upon the insolvency of a Spanish party (an entity or an individual) being declared:

- (i) those actions which are judged detrimental to the estate of the insolvent party and which have been carried out during the two years preceding such date, may be rescinded even in the absence of fraudulent intention;
- (ii) the detriment to the estate is presumed *iusuris et de iure* (i.e., without it being possible to provide evidence to the contrary) in the case of actions of disposal for no consideration (except for customary gratuities), and payments or other actions aimed at discharging obligations with an original date of maturity subsequent to the date of the insolvency declaration, except where the discharged obligation is secured with an right *in rem*, in which case paragraph (iii) (c) below shall apply;
- (iii) furthermore, detriment is presumed *iusuris tantum* (i.e., unless evidence is provided to the contrary) in the event of: (a) disposal actions carried out in favour of a party related to the insolvent party; (b) the creation of guarantees *in rem* (security interests) for the benefit of pre-existing obligations or of new obligations replacing previously existing ones (except for refinancing transactions where certain conditions are fulfilled as established pursuant to the recently enacted Royal Decree 4/2014, of 7 March); and (c) payments or other actions aimed at discharging obligations secured with a right *in rem* with an original date of maturity subsequent to the date of the insolvency declaration;
- (iv) in the case of actions not included in any of the above two categories, the detriment must be proven by the person bringing the action of rescission (e.g., the insolvency official);
- (v) ordinary actions taken by the debtor as part of the ordinary course of business under normal conditions will not be subject to clawback actions described in paragraphs (i) to (iv); and
- (vi) notwithstanding the above, actions of rescission will not be available in the event that the beneficiary of the detrimental action proves that such a transaction is governed by a foreign law which does not permit its rescission in any case.

This general regime applies to the sale of receivables benefiting from the ordinary and privileged regimes. Notwithstanding, where the sale of receivables is made in favour of an FTA, such sale shall not be rescindable unless evidence is given of the fact that fraud existed at the time the assignment was made.

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

Such consolidation of insolvency proceedings should not be carried out under normal circumstances. Spanish law provides for an accumulation of insolvency proceedings in situations, under the terms of Chapter III of the Spanish insolvency law, where purchaser and seller are closely related parties (e.g., members of the same group) or where their respective estates cannot be separated.

If the insolvency proceedings of two entities are accumulated, they will be processed in a coordinated manner, but without consolidating their assets and liabilities. Thus, Spanish law does not contemplate “substantive” consolidation in an insolvency scenario, other than in respect of certain procedural matters (aimed at making the insolvency proceedings more time and cost efficient).

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Spain, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

Where an agreement has been entered into by the seller and the purchaser for the sale of the seller’s future receivables arising out of contracts, as specified or generally described in the sale agreement, and the seller is declared insolvent, the general principles should provide for the need to ensure that the transfer is generally respected and that the receivable arises in the estate of the purchaser, even in the context of an insolvency of the seller. However, this matter remains a disputed issue under Spanish law, i.e., whether the receivables arising after the declaration of the insolvency situation must be subject to the insolvency or directly arise as part of the purchaser’s estate, thus being left outside of the seller’s insolvency estate. Though the court precedents are scarce and not yet definitive, it is generally accepted that “privileged” transfers of future receivables (please refer to question 4.1) should be upheld by the insolvency officials and the judge.

**6.6 Effect of Limited Recourse Provisions. If a debtor’s contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

Yes, it can.

**7 Special Rules**

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Spain establishing a legal framework for securitisation transactions? If so, what are the basics?**

Standard, market-oriented securitisation transactions are structured through FTAs, and their close relatives, Mortgage-Backed Securitisation Funds (*Fondos de Titulización Hipotecaria*, hereinafter, “FTH” and together with FTA, the “Funds”). FTHs can only securitise certain specially defined mortgage loans. Hence, the assets of a FTH will always consist in a pool of PHs.

These Funds are the standard vehicles designed by the Spanish legislator to develop the local market for securitisation transactions aimed at the general public. Additionally “private” securitisation (i.e., non-listed transactions addressed to qualified investors) are allowed provided that the relevant ABS/MBS bonds will not be listed in the Spanish regulated markets and that such bonds are subscribed by institutional investors (hereinafter, “Private Funds”).

A Fund is defined as a separate estate that lacks legal personality (*personalidad jurídica*) and is represented by the managing company. Therefore, all actions taken by, and all agreements, transactions or arrangements entered into by the managing



company on behalf of the Fund will be deemed, under Spanish law, to be actions taken and agreements, transactions or arrangements entered into by the Fund.

To date, the securitisation regime has been scattered across a number of different laws. Accordingly, there was no such thing as a special securitisation law. However, the Draft Law to Foster Company Funding provides for a new securitisation regime. Nevertheless, said Draft Law is a mere proposal driven by the Spanish government, which it is at a very early stage. Accordingly, relevant amendments may be incorporated, if it is finally passed.

#### 1. Assignment of receivables to a FTA

Please refer to questions 4.1, 4.2 and 4.11 above for a discussion on the conditions for the assignment of receivables to an FTA.

#### 2. Types of FTA

Closed funds: the assets transferred thereto and the liabilities thereof will not be modified as from the date of the incorporation of the Fund, without prejudice to possible replacements in certain cases, such as the existence of non-eligible assets. FTH shall be closed funds.

Open funds: the assets of the fund, or its liabilities, or both of them, may be modified (renewed) and/or extended after the incorporation of the fund. For instance, new assets may be assigned to the FTA or new notes issued to finance the existing portfolio.

#### 3. Funding of the Funds

**Fixed income securities.** The total amount of the securities issued must be above 50 per cent of the total liabilities. The securities issued by a Fund are generally called securitisation bonds (*bonos de titulización*) and normally the different series of securities issued will have different levels of seniority. The financial risk of the securities issued must be rated (except in case of a Private Fund) by a rating agency recognised by the CNMV for such purposes.

The securities are issued under the terms of the incorporation public deed of the Fund. Unlike other jurisdictions, there is no such thing as a trustee; the bondholders will be represented by the managing company and they will not have any individual right other than the claim against the Managing Company/Fund for breach of the relevant contracts and legal duties.

Securities are normally repaid following a pass-through model (i.e., repayment takes place in the same sum and time as the underlying assets are actually generating cash).

**Loans granted by credit institutions.** Contributions by qualified investors (*Inversores Institucionales*), such as credit institutions, insurance companies, certain investment firms and other types of schemes and investment entities established under Spanish laws. Typically, these loans will be subordinated to the securities issued by the Fund, as a credit enhancement to upgrade the credit rating of the bonds.

#### 4. Incorporation of a Fund

The basic requirements (some of which may be exempted) are the following:

- Previous communication to the CNMV.
- Informative Prospectus (Offering Circular), which must be registered with the CNMV and examined thereby. The Prospectus will not be required in the event that the issue is addressed to institutional investors and the relevant bonds will not be listed in the Spanish regulated markets (i.e., a Private Fund).
- Rating of the securities to be issued (except in case of a Private Fund).
- The securitised receivables must be audited by an auditor.
- Formalisation of a public deed of incorporation before a Spanish Notary Public.

#### 5. Managing company

A Spanish managing company of securitisation funds (*Sociedad Gestora de Fondos de Titulización*) duly incorporated and authorised by the CNMV, will be responsible for the incorporation, management and representation of the Fund. The managing company will be empowered with any rights conferred upon the Fund as holder of the securitised portfolio of assets and has the duty to safeguard the interests of the bondholders and other borrowers of the Fund.

#### 7.2 Securitisation Entities. Does Spain have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Please refer to question 7.1. Funds enjoy a special treatment in relation to some legal aspects, such as clawback provisions in case of insolvency of the seller or a special tax regime, which are analysed under other questions of this chapter.

As Funds are not legal entities, they do not have shareholders or directors. However, shareholders with a significant stake in a management company (basically, more than 10 per cent) need to meet certain individual suitability standards, and members of the board of directors need to be honourable, the majority of them having to be experienced.

#### 7.3 Limited-Recourse Clause. Will a court in Spain give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

A Spanish court would, in principle, give effect to a contractual provision whereby one of the parties agrees to limit recourse to a limited number of the other party's assets.

#### 7.4 Non-Petition Clause. Will a court in Spain give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Voluntary waiving of rights recognised by law shall not be valid if deemed to be contrary to public order, or made to the prejudice of a third party; furthermore, under Spanish law, waiver of future rights not yet existing or of pure expectations could be deemed null and void, unless ratified at the time of the existence of the rights. The right to bring an action where there was fraud or wilful misconduct cannot be validly avoided by the parties. Further, a full and unconditional waiver of any action may be found to lack any cause and be held invalid.

As for the non-insolvency clauses, they may be validly agreed upon by the parties, though no such clause will have any efficacy *vis-à-vis* third parties. Even if the contractual provision was deemed valid and effective, it is most likely that the court would admit the legal action or the application of insolvency, without prejudice to the effects among the parties that such contractual breach could bring.

**7.5 Priority of Payments “Waterfall”. Will a court in Spain give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

Waterfall schemes will be generally respected unless conflicting with mandatory provisions of Spanish law. Similarly, waterfall schemes should be expected to be scrutinised by insolvency officials, and rejected to the extent they may lead to a prejudice for the Spanish debtor or infringe other Spanish insolvency rules.

**7.6 Independent Director. Will a court in Spain give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

Spanish directors are bound by fiduciary and other legal duties including, among others, the duty to seek insolvency protection where legally required. Failure to comply with those duties will expose the directors to direct and immediate legal liability *vis-à-vis* the company and its creditors, among others.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Spain, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Spain? Does the answer to the preceding question change if the purchaser does business with other sellers in Spain?**

In principle, the only activity reserved to credit institutions in Spain is the gathering of reimbursable funds from the public (deposits) on a general basis. Therefore, the business of acquiring existing portfolios of receivables is not generally regarded as one requiring prior administrative authorisation as a financial entity.

Locally incorporated Funds and their Managing Companies are subject, among other legislation, to certain Spanish capital market regulations and to the CNMV’s surveillance.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

Servicing and administration of the assigned receivables does not itself entail the need to obtain a local licence. However, a local licence may be required to the extent that the actual administration activities fall within the scope of a regulated sector (e.g., insurance mediation).

Additionally, as a general rule, the assistance of a court agent (*procurador*) and a lawyer is required to appear in court.

**8.3 Data Protection. Does Spain have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

Yes. Organic Law 15/1999, of 13 December, on Personal Data Protection (and other implementing and related regulations, such as Royal Decree 1720/2007, of 21 December), restricts the use and dissemination of personal data of individual obligors. In order for a personal data controller to use and/or transfer personal data to a third party legally (regardless of whether the third party is located in Spain or abroad), the data subject must be informed, before or upon the process and/or transfer, of the processing that will be carried out and/or the circumstances of the transfer (which includes, among others, identifying the recipient(s)), and additionally, the process and/or the transfer must rely on a “legitimate ground” listed in the law (e.g., when the process or transfer is authorised by law or when the data subject’s consent has been obtained). The controller’s legitimate interest is considered as a “legitimate ground”, however, its application must be carefully analysed on a case-by-case basis.

In certain cases in which the data is transferred to a country outside the European Economic Area whose regulations, as identified by the European Commission or the Spanish Data Protection Agency, do not afford an adequate level of protection, then the controller must obtain the Spanish Data Protection Agency’s prior authorisation, unless the transfer relies on one of the exemptions thereto exhaustively listed in the Spanish regulations (e.g., when the prior and unambiguous data subject’s consent to process his/her personal data in such country has been obtained).

As a general rule, Organic Law 15/1999 does not apply to data of enterprises (with the exception of sole traders that may be considered as “individuals” for data protection purposes). In any case, other rules (for instance, banking secrecy and contractual confidentiality duties) may hinder the ability of a seller/purchaser to disclose in a publicly available document (e.g., a prospectus) key data of the assigned debtor.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Spain? Briefly, what is required?**

No. However, if the receivables assigned to the purchaser are subject to Act 16/2011, the consumer-obligor of the receivable must be informed of the transfer (except in case the seller keeps providing services) and the consumer-obligor may exercise against the purchaser the same exceptions which he could exercise against the seller (including the right to set-off).

**8.5 Currency Restrictions. Does Spain have laws restricting the exchange of Spanish currency for other currencies or the making of payments in Spanish currency to persons outside the country?**

No restrictions are imposed on the transfer of receivables from the seller to a foreign purchaser.

However, pursuant to the Bank of Spain Circular 4/2012, of April 25, Spanish entities have the obligation to report to the Bank of Spain their transactions with non-Spanish residents and their assets and liabilities held outside Spain. This reporting obligation must be observed with the following frequency depending on the amount of

the transactions performed during the preceding year with non-Spanish residents or the amount of the balance of assets and liabilities abroad:

- (i) Monthly reporting: if equal to or above EUR 300 million.
- (ii) Quarterly reporting: if equal to or above EUR 100 million, but below EUR 300 million.
- (iii) Annual reporting: if equal to or above EUR 1 million, but below EUR 100 million.

Nevertheless, failure to comply with this reporting obligation, if applicable, does not render the undeclared transaction invalid or ineffective.

## 9 Taxation

### 9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Spain? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?

Income obtained by the non-Spanish resident purchaser on the difference between (i) the payments made by the obligors, and (ii) the purchase price paid by the purchaser to the seller (i.e., taking into consideration any agreed discount) may be regarded by the Spanish tax authorities as either Spanish source interest income or as a capital gain. To the best of our knowledge, there are no rulings issued by the Spanish tax authorities or the Spanish courts on the subject of the transfer of receivables and its classification for Spanish direct income tax purposes.

However, under an internal exemption of the Non-Resident Income Tax, income obtained by the purchaser, regarded either as interest or as capital gains, will not be subject to Spanish tax to the extent that the purchaser: (i) is resident in an EU Member State for tax purposes and may obtain and submit a certificate of tax residence issued by the relevant tax authorities of its country of residence; (ii) does not act with respect to the transaction through a permanent establishment located in Spain or outside the EU; and (iii) does not act through a territory regarded as a tax haven jurisdiction for Spanish tax purposes.

Regarding interest paid by the obligor to the seller if the latter is a Spanish company, it will be typically subject to withholding tax (not applicable to a financial entity) at a rate of 19 per cent (or 21 per cent for calendar year 2014). Indeed, since the assignment of the receivable is not disclosed to the obligor, the obligor will assume that the payment is due to the Spanish seller, and that the withholding tax is due i.e., the tax is levied on the Spanish seller, not on the purchaser.

### 9.2 Seller Tax Accounting. Does Spain require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

A Spanish seller will need to follow the Spanish GAAP on de-recognition of financial assets. This rule focuses on the existence of an actual transfer of risk and benefits by the seller to the

purchaser and is in line with the International Accounting Standards adopted by the European Commission. The tax law will follow the accounting rule in this matter.

### 9.3 Stamp Duty, etc. Does Spain impose stamp duty or other documentary taxes on sales of receivables?

Stamp duty will be levied upon the issuance of those Spanish receivables which credit right is evidenced by bills of exchange (*letras de cambio*), promissory notes (*pagarés*), or other draft documents in which the document has the purpose of transferring funds (*título-valor*; *documento cambiario* or *instrumento con función de giro*), on the basis of its amount and its maturity.

However, registered promissory notes which are issued on a non-endorsable basis (*pagarés nominativos no a la orden*) will not be subject to stamp duty unless, pursuant to Article 33 of the Transfer Tax and Stamp Duty Law, they are issued as part of a series, with a maturity shorter than 18 months and with a consideration represented by a discount over the face value. Notwithstanding this, in such a case, these notes will benefit from the exemption regulated in Article 45.I.B 15 of the Transfer Tax and Stamp Duty Law.

In general terms, stamp duty will be levied upon the issuance of the draft document rather than as a consequence of its transfer. However, any person who intervenes in connection with the circulation of the draft documents, including the purchaser, will be joint and severally liable to the issuer of the instrument for any unpaid stamp duty.

### 9.4 Value Added Taxes. Does Spain impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

In accordance with Spanish law, a sale of receivables, as any transfer of credits, is subject to, but exempt from VAT, to the extent that the transfer of credits by the seller to the purchaser is made without recourse and, consequently, the seller does not assume the risks of insolvency of the debtors.

In principle, under Spanish VAT Law, collection services receive a different tax treatment than that applicable to the transfer of credit with or without recourse. Therefore, there would be grounds to maintain that the collection services provided to the purchaser should be subject to VAT since collection services do not benefit from the VAT exemption set forth in the VAT Law for the transfer of credits without recourse (Article 20.1.18.e of the VAT Law).

However, under the general rule contained in Article 69.1 of the VAT Law concerning the place from where the supply of services is deemed to be rendered for VAT purposes, collection services are deemed to be supplied in the state where the customer has established its business, or has a fixed permanent establishment to which the service is supplied, or, in the absence of such place, the place where it has its permanent address or usually resides.

Thus, if the entity to which the services are supplied (i.e., the purchaser) is not established in Spain for VAT purposes, the services will not be deemed to be supplied in Spain and, therefore, will not be subject to Spanish VAT.

Having said the above, if the agreement entered into by the seller and the purchaser qualifies as a factoring agreement, there would be a range of services deemed to be rendered for VAT purposes by the purchaser to the seller (namely, financial services, management and collection services and, if applicable, guarantee services). In particular, the management and collection services, and the

guarantee services, would be subject to and not exempt from Spanish VAT and the seller should assess the VAT due on that transaction given that the supplier of the service (i.e., the purchaser) is not established in the Spanish VAT territory. Additionally, the delivery of the receivables by the seller to the purchaser will not qualify as a VAT taxable transaction and will be disregarded for any VAT purposes (including for purposes of assessing the entitlement of the seller to deduct any input VAT borne).

---

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

---

Following Spanish VAT Law, recipients of the supplies of goods and services may be liable for unpaid VAT under certain circumstances. That is the case with those recipients of goods or services who, through any intentional acts or omissions, avoid the correct chargeability of VAT.

Likewise, any purchaser of goods may be liable for any unpaid liability triggered on prior acquisitions of the same goods acquired when the goods were purchased for a price lower than the market value, if the acquirer should have presumed in light of the relevant evidence that the VAT corresponding to the previous supply of the same goods was not paid. Finally, there are a number of cases where entities acting in the name of the importer (either as an agent or as a representative) might be liable for VAT not paid by the taxpayer (the importer).

It may follow from this that the role of the purchaser (limited to the acquisition of receivables from the seller) should not lead to this entity becoming liable for any VAT not charged, or unpaid by the seller in its commercial dealings with the obligors.

In addition, general tax law allows the tax authorities to claim the payment of taxes by entities or individuals other than the taxpayer (the seller) when such Spanish tax authorities understand and provide evidence of: (i) the collaboration of the purchaser in the tax law infringement; or (ii) the transfer of a business activity to the purchaser as an on-going concern (which would not be applicable in a sale of receivables).

---

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Spain, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Spain?**

---

In such an scenario, the seller may constitute a permanent establishment of the purchaser in Spain (and thus, subject to Spanish taxation), if the seller, in its status as a service provider, acts as an agent of the purchaser with the right to enter into agreements with third parties e.g., the obligors, on behalf of the purchaser.

This would typically not be the case. Nevertheless, in order to exclude the risk of a permanent establishment, the seller should not be provided with any powers of attorney of relevance with respect to the purchased receivables (e.g., contemplating the right to forgive, set-off, reduce or postpone collection of the receivables), but only with the faculties related to the cash collection of the receivables.

### Acknowledgment

We would like to thank Miguel Bastida Peydro (senior associate, tax) and Roberto Medrano Martínez (associate, tax) for their contribution to the taxation section of this chapter.



### Ramiro Rivera Romero

Uría Menéndez Abogados, S.L.P.  
C/ Príncipe de Vergara 187  
Plaza de Rodrigo Uría  
28002 Madrid  
Spain

Tel: +34 91 586 0073  
Fax: +34 91 586 0777  
Email: [ramiro.rivera@uria.com](mailto:ramiro.rivera@uria.com)  
URL: [www.uria.com](http://www.uria.com)

Ramiro Rivera is a partner in the Madrid office of Uría Menéndez. He joined the firm in 1989 and became a partner in 1998. He acquired first-hand experience in Latin America by heading the Buenos Aires office from 1998 to 2001. Between 2001 and 2003, he headed the Latin America Practice Group of Uría Menéndez and coordinated the Corporate Department of the firm in Madrid from 2002 to 2006 and the Financing Department from 2010 to 2013.

Ramiro focuses his practice on capital markets, banking, corporate and commercial law and has extensive experience in managing and coordinating multi-jurisdictional transactions.

In addition, Ramiro heads the firm's Securitisation Working Group and has vast experience in securitisation and other structured finance deals. He also advises listed companies on a number of capital markets-related transactions, and is currently the Secretary to the Board of Directors of DIA, an Ibex 35 company. Ramiro's work in Capital Markets and Securities has been recognised by the most prestigious legal directories (IFLR 1000, European Legal 500, Chambers, etc.).



### Jorge Martín Sainz

Uría Menéndez Abogados, S.L.P.  
C/ Príncipe de Vergara 187  
Plaza de Rodrigo Uría  
28002 Madrid  
Spain

Tel: +34 91 587 0976  
Fax: +34 91 586 0777  
Email: [jorge.martin.sainz@uria.com](mailto:jorge.martin.sainz@uria.com)  
URL: [www.uria.com](http://www.uria.com)

Jorge Martín joined the Madrid office of Uría Menéndez in March 2010 and is currently an associate in the Finance practice area. He graduated from the *Universidad Pontificia de Comillas* with a dual degree in Law and Business Administration, participating in a six-month Erasmus programme at the Aarhus University Law School and in another six-month programme at the Emory University Goizueta Business School.

Jorge focuses his practice on corporate, M&A, banking and capital markets Law. He has been involved in several local securitisation transactions performed by Spanish credit entities and international structured finance transactions.

## URÍA MENÉNDEZ

Uría Menéndez has been at the forefront of the design and development of securitisations in Spain and of other non-recourse-structured financing transactions based on cash flows, income, or the value of assets or underlying businesses.

In 1991, the firm advised one of the main Spanish banks on the first securitisation carried out in Spain and Portugal. The firm's experience strongly influenced the drafting of the first statute on the subject, Law 19/1992, of 7 July, on property investment firms and funds and mortgage securitisation funds.

Since then, Uría Menéndez has been involved in several other securitisation transactions for banks, savings banks and industrial and commercial companies involving a diverse range of assets including personal loans, loans granted in connection with the rental of vehicle fleets, and other commercial loans as well as in innovative transactions such as the assignment of set-off rights arising from recognition of the rate deficit affecting the electrical sector in 2000-2002. The securitisations have been structured both in Spain and internationally.

Our diverse securitisation clients include originators, monoline insurers, management firms, guarantors, and rating agencies, as well as investment banks and other financial institutions.

Uría Menéndez has unparalleled experience in issues of securities by Mortgage Securitisation Funds and Asset Securitisation Funds in the Spanish market, in both public (listed on the Spanish AIAF market) and private transactions.

# Sweden



Stefan de Hevesy



Albert Wällgren

Advokatfirman Vinge KB

## 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

(a) No, there are no formal requirements (except for certain special agreements, such as transfer of real property and consumer credit agreements), but it is generally advisable to document the debt obligation for reasons of evidence.

(b) Since an invoice is unilaterally issued, it does not in itself constitute evidence of an enforceable debt obligation. However, it may be used to show evidence of an underlying debt obligation. If the invoice is disputed, the underlying agreement or the factual circumstances creating the actual debt obligation would need to be proven.

(c) Yes, but it may be difficult to provide evidence of the debt obligation if it is being disputed.

**1.2 Consumer Protections. Do Sweden’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

(a) No, except limits provided by the general usury provisions in the Swedish Contracts Act. Further, the Swedish Consumer Credit Act includes a general requirement for the creditor to observe generally accepted standards for granting of credit, but that does not limit the rate of interest *per se*.

(b) Yes, the Swedish Act on Interest provides a statutory right to interest on late payments. Unless the parties have agreed on a different rate, the default interest rate will be the Swedish Central Bank’s reference rate (which is determined semi-annually and which was set at 1 per cent at the beginning of 2014) plus 8 per cent.

(c) Yes, a consumer has the right to withdraw from and cancel the credit within 14 days from the date of agreement or (if later) the date upon receipt of certain specified information and documentation. In addition, the consumer generally has the right to repay the credit in advance of its maturity.

(d) In addition to the general requirement mentioned under (a) above, the Swedish Consumer Credit Act includes various consumer rights, such as the right to certain information, right to access documentation, rights of early repayment and cancellation, restrictions on interest rate changes and restrictions on early termination. Further, the consumer generally has the same right to set-off and to make objections against a transferee as it had towards the originator, and the use of negotiable promissory notes is prohibited for consumers’ purchases on credit. Further, the Swedish Financial Supervisory Authority (the “FSA”) has issued guidelines regarding what information to be provided to consumer obligors in connection with securitisations.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

No specific requirements apply to the sale or collection of government receivables, but government agencies and bodies are generally immune to enforcement actions.

## 2 Choice of Law - Receivables Contracts

**2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Sweden that will determine the governing law of the contract?**

The governing law of the contract of non-negotiable receivables will be determined in accordance with the Rome I Regulation. In the absence of choice of law by the parties, the Rome I Regulation contains presumptions of applicable law. If the contract does not fall within any of the listed types of contract, applicable law shall be the law in the country where the party that has to perform the characteristic obligations under the contract is located. However, if it is clear from all relevant circumstances that the contract is manifestly more closely connected with another country than the presumed country above, the law of that other country shall apply. Finally, if applicable law cannot be determined in accordance with the above, the contract shall be governed by the law of the country with which it has the closest connection. In addition, special regulations apply to, for example, consumer contracts.

**2.2 Base Case.** If the seller and the obligor are both resident in Sweden, and the transactions giving rise to the receivables and the payment of the receivables take place in Sweden, and the seller and the obligor choose the law of Sweden to govern the receivables contract, is there any reason why a court in Sweden would not give effect to their choice of law?

No, there is not.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor.** If the seller is resident in Sweden but the obligor is not, or if the obligor is resident in Sweden but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Sweden give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

In principle, according to the Rome I Regulation a contract shall be governed by the law chosen by the parties. The parties may at any time choose applicable law, and the choice can be express or implied. One exemption to the general rule is when all relevant circumstances are located in one or more EU Member States and the parties' choice of law is one of a non-EU Member State. In such a case the parties' choice shall not prejudice the application of mandatory provisions of EU law. Furthermore, the freedom of choice is limited in cases where the contract lacks international characteristics. Hence, for example, Swedish mandatory provisions will apply in the event that all relevant circumstances relate to Sweden. Finally, the choice of law will not be upheld by a Swedish court if the provisions of that foreign law contravene Swedish *ordre public* or international mandatory provisions. A Swedish court may also give effect to mandatory provisions of the law of the country where the performance of the contractual obligations will take place.

**2.4 CISG.** Is the United Nations Convention on the International Sale of Goods in effect in Sweden?

Yes, CISG has been in effect in Sweden since 1 January 1989. CISG is, however, not applicable to purchases where both the seller and the buyer are located in any of the Nordic countries.

### 3 Choice of Law - Receivables Purchase Agreement

**3.1 Base Case.** Does Swedish law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Swedish laws or foreign laws)?

No, in respect of the receivables purchase agreement the parties are generally free to choose a different law than the law governing the receivables. However, pursuant to the Rome I Regulation the law governing the receivables will apply concerning the assignability of the receivables, the relationship between the purchaser and the obligor, the conditions under which the assignment can be enforced against the obligor and whether the obligor's obligations under the receivables have been paid and discharged in full.

**3.2 Example 1:** If (a) the seller and the obligor are located in Sweden, (b) the receivable is governed by the law of Sweden, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Sweden to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Sweden, will a court in Sweden recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

The relationship between the seller and the obligor (or the seller and the purchaser) is regulated by the Rome I Regulation, see above. Concerning the question whether the transfer of receivables is enforceable in relation to third parties, the Rome I Regulation lacks regulations. Neither is the matter expressly regulated in Swedish law. However, the predominant view in Sweden is that applicable law will be the law of the country where the relevant asset is located (the *lex rei sitae*) and that a receivable is located at the domicile of the obligor. Thus, a Swedish court would be likely to base its analysis on the perfection requirements in the substantive law of the obligor's domicile. The answers to Examples 1-5 below will be based on this predominant view. However, as a precautionary measure, in case the perfection requirements differ between the relevant countries, we recommend to comply with the requirements in both/all relevant countries.

In Example 1, since the obligor is located in Sweden, a Swedish court would recognise a sale as being effective against third parties, provided that the sale has been properly perfected under Swedish law. As regards requirement for the sale to be perfected under Swedish law, please refer to questions 4.2 and 4.3.

**3.3 Example 2:** Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Sweden, will a court in Sweden recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

As described in question 3.2, if the obligor is located outside of Sweden, it is likely that a Swedish court would conclude that the receivables are located at the domicile of the obligor, and accordingly that the law of that country shall apply. Hence, the sale will not be effective against third parties if the perfection requirements of that other country have not been complied with.

**3.4 Example 3:** If (a) the seller is located in Sweden but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Sweden recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Swedish own sale requirements?

As described in question 3.2, it is likely that a Swedish court would conclude that the perfection requirements shall be subject to the substantive law of the obligor's domicile. Provided that the perfection requirements of that foreign law have been complied

with, a Swedish court would recognise the sale as being effective against third parties.

**3.5 Example 4: If (a) the obligor is located in Sweden but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Sweden recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Swedish own sale requirements?**

As described in question 3.2, it is likely that a Swedish court will apply Swedish law since the obligor is located in Sweden. Accordingly, if the Swedish perfection requirements have not been complied with, the sale will not be effective against third parties.

**3.6 Example 5: If (a) the seller is located in Sweden (irrespective of the obligor's location), (b) the receivable is governed by the law of Sweden, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Sweden recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Sweden and any third party creditor or insolvency administrator of any such obligor)?**

As described in question 3.2, it is likely that a Swedish court would base its analysis on the perfection requirements in the substantive law of the obligor's domicile.

## 4 Asset Sales

**4.1 Sale Methods Generally. In Sweden what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

A straightforward transfer/sale and purchase (Swedish law does not distinguish between the two) and the most widely used terms would be transfer or sale/purchase. Assignment would also be a recognised method and term, but it could imply that it is in fact a security arrangement (please refer to question 4.9).

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

The perfection requirement in relation to non-negotiable promissory notes/receivables is notice to the obligors. In relation to negotiable promissory notes/receivables, the original bearer document needs to be delivered to the purchaser. A notice to the obligor is not a strict perfection requirement, but pursuant to

guidelines issued by the Swedish FSA, notification will also be required to be made in relation to obligors of negotiable promissory notes. In both cases it is also a requirement that the seller is precluded from dealing with the receivables.

The requirement that the seller must no longer be able to deal with the receivables is generally held to mean that the seller must not collect in its own name and it must not be allowed to use the funds collected or to agree to any amendments without the purchaser's consent. It does not mean that arrangements allowing for continued servicing and collection by the seller are not possible. There are no further requirements or formalities.

**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

Please see question 4.2 for perfection requirements. Please note, however, that if the seller is a bank, a credit market company or a securities company, a legal exception allows for the bearer notes to remain in the seller's possession, which simplifies continued servicing by the seller.

If the bearer notes are in the possession of a third party (e.g. a custodian), the relevant perfection requirement is notification to such third party. The relevant perfection requirement for dematerialised bearer documents (including marketable debt securities) is to electronically transfer them to a new electronic archive (or, if held by a third party, such as Euroclear Sweden or an account keeping institution, notification to such third party).

The perfection requirements listed here in question 4.3 and in question 4.2 apply also to e.g. mortgage loans, consumer loans or marketable debt securities (subject to that, it is advisable that pertaining security is perfected separately as mentioned in question 4.12). The distinguishing factor is whether they are negotiable or non-negotiable documents.

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

Yes, either (or both) of them need to notify the obligors, unless the relevant receivables are evidenced by negotiable promissory notes (in which case notification is still recommended).

As a starting point, the obligors' consent is not required and that will not vary as a result of (a). As regards (b), please refer to question 4.6 regarding contractual restrictions on assignment.

For non-negotiable promissory notes, one benefit with notification is that the obligor is no longer able to pay the seller with discharging effect. Further, the notice will cut off the obligor's right to set-off a counterclaim against the purchaser if such counterclaim was (i) acquired after receipt of the notice, or (ii) if such counterclaim falls due for payment after both the receivable and receipt of the notice.



**4.5 Notice Mechanics.** If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There are no requirements to the form or method of delivery of the notice. However, the burden of proof lies with the sender, so the notice should be unambiguous and it should be verified that it is actually received by the obligor.

The notice cannot be delivered after insolvency proceedings against the seller have commenced, because the receivables would then form part of the assets of the seller's bankruptcy estate. The notice can be delivered after insolvency proceedings against the obligor have commenced, provided that the purchaser has time to make himself known as a creditor in the obligor's insolvency. The notice can apply also to future receivables.

**4.6 Restrictions on Assignment - General Interpretation.** Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?

Yes, unless the obligor's consent is obtained. As regards the second question, it will depend on whether "the Agreement" is for example a promissory note (or other type of loan agreement) where the receivable is the characteristic element, or an agreement where the receivable thereunder is not the characteristic element (such as a supply agreement, construction agreement, framework agreement or a sale of goods agreement). In the former case, the transfer restriction will be effectively prohibiting a transfer of the receivable, whereas in the latter case, the transfer restriction will be interpreted as referring to the Agreement as a whole, and one or several receivables thereunder is transferable.

**4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Sweden? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Sweden recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Yes, such restrictions are generally enforceable and there are no general exceptions. The seller will be liable to the obligor for breach of contract.

**4.8 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells *all* of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

There are no requirements, except a general requirement that it must be clear what receivables are being sold.

**4.9 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

Under Swedish law, the parties' intention when entering into an agreement is an important factor when interpreting the agreement. A Swedish court will however enquire also into the economic characteristics of the transaction (substance over form), which could lead to re-characterisation of an intended sale (true sale) to a security assignment. However, as mentioned in question 5.1, the perfection requirements are substantially the same and the main result would not be that the sale/security is unperfected, but that the seller has right to any excess value.

It is not possible to give a clear answer to what extent the seller may retain (a)-(d) without jeopardising a true sale, since the court will take all circumstances into consideration, and these are all relevant factors in such determination by the court. A right to repurchase/redemption (or disposal restrictions for the purchaser) is generally viewed as one indication of a security arrangement. The same applies to control of collections, if made in the name of and on behalf of the seller.

**4.10 Continuous Sales of Receivables.** Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes, however, perfection requirements will need to be adhered to and receivables arising after the application for bankruptcy of the seller will form part of the seller's bankruptcy estate, and completion of any sale of receivables thereafter consequently requires the consent of the bankruptcy receiver.

**4.11 Future Receivables.** Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?

Yes, the answer is the same as the answer to question 4.10.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

The main rule is that the receivables can be sold together with pertaining security without any additional formalities required. However, in order to be able to enforce the security in an efficient manner, the transfer of relevant security should be perfected separately (registration, physical delivery of bearer documents, notification to third parties, etc.).

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

As a starting point, for non-negotiable promissory notes, the obligor keeps its right to set-off. For exceptions, please refer to question 4.4. For negotiable promissory notes, the set-off right generally terminates upon perfected transfer of the notes. However, the obligor still has the right to set-off if: (i) the counterclaim originates from the same legal relationship; or (ii) there is a risk that the obligor will not receive payment from the seller as a result of the transfer, and the purchaser was aware of the obligor's counterclaim and the effect that the transfer could have thereon. The obligor's set-off rights cannot be terminated by the seller or the purchaser other than as described above, and such termination will not make the seller or the purchaser liable for damages (although the obligor will still hold its counterclaim against the seller).

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Sweden to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

No, under Swedish law, the perfection requirements for a sale of receivables and the granting of a security interest over receivables are substantially the same.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Sweden, and for such security interest to be perfected?**

Please refer to questions 4.2 and 4.3 regarding the receivables and question 4.12 regarding related security.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Sweden to grant and perfect a security interest in purchased receivables governed by the laws of Sweden and the related security?**

Under Swedish law, the perfection requirements for a sale of

receivables and the granting of a security interest over receivables are substantially the same – these are described under questions 4.2 and 4.3. Please see question 4.12 in relation to related/pertaining security.

For a Swedish pledgor, it is possible to grant security over substantially all of the pledgor's property (including receivables) through a pledge of corporate mortgages (Sw. *företagshypotek*). Such pledge is however limited to the assets of the pledgor at the time of enforcement and to the face amount of issued mortgages. Stamp duty at a rate of 1 per cent of the face amount of any corporate mortgage issued, will be payable.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Sweden, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Sweden or must additional steps be taken in Sweden?**

If the security interest is valid and perfected under the laws of the purchaser's country there are no mandatory rules in Sweden that would affect such validity or perfection, on the basis that the receivable is governed by Swedish law.

If the laws of the purchaser's country would point to Swedish law when determining whether the security interest is valid and perfected, Swedish conflict-of-laws rules would probably (the issue of applicable law to rights *in rem* in contractual obligations has not been finally resolved) point to the domicile of the obligor as the place where the receivable is "located" and such law would thus govern the perfection. Please refer to questions 4.2 and 4.3 for perfection requirements under Swedish law.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

In relation to all security interests, there must be an underlying pledge agreement under which the security is granted.

The perfection requirement in relation to insurance policies is notification to the relevant insurance company.

The perfection requirements for promissory notes, loans and marketable debt securities are described in question 4.3.

**5.6 Trusts. Does Sweden recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

The concept of a trust is not recognised under Swedish law. However, the Swedish Escrow Funds Act provides that the purchaser has a right of separation to any monies received by the seller, which, in accordance with the act, is held by the seller on account of the purchaser on a separate account.

**5.7 Bank Accounts. Does Sweden recognise escrow accounts? Can security be taken over a bank account located in Sweden? If so, what is the typical method? Would courts in Sweden recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Sweden?**

Sweden recognises escrow accounts. The use of an escrow account

will be governed by an agreement between the parties and the account bank.

Security over bank accounts located in Sweden may be taken by entering into a pledge agreement and notifying the relevant account bank.

A Swedish court would require that Swedish perfection requirements with respect to bank accounts are met, regardless of any perfection actions taken under the English law debenture.

Please refer to question 5.9 regarding the use of bank accounts while pledged.

---

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

---

Yes. The account bank has set-off rights with respect to the cash held on the account, unless contracted out of.

---

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

---

No, the pledgor must be cut off from being able to make withdrawals or in any other way deal with monies held in the pledged account. The pledgee may however agree, on a case by case basis, to release any amount covered by the pledge.

If the pledgor needs to access the funds in order to operate its day-to-day business, a common solution is to include a provision that the pledgor will only be cut off from access to the account upon the occurrence of an event of default (or similar). Such arrangement entails a delayed perfection subject to clawback.

## 6 Insolvency Laws

---

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Sweden's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

---

There is no automatic stay of action and the receiver in bankruptcy is not empowered to collection and enforcement actions whether in relation to perfected sales or in relation to security arrangements. Please refer to question 6.3 regarding clawback.

---

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

---

The receiver in bankruptcy does not have the power to prohibit the purchaser's exercise of rights.

---

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Sweden for (a) transactions between unrelated parties, and (b) transactions between related parties?**

---

A sale of receivables on arm's length terms (i.e. with a market value consideration) would normally not be subject to clawback. If the arrangement is re-characterised as a security arrangement (or is intended to be a security arrangement) the hardening period is three months for security granted for old debt or security where perfection has been delayed for more than two weeks.

In order for assets subject to a perfected sale to be recovered in bankruptcy, the sale has to have been effected in an improper manner resulting in: (a) one creditor being favoured in preference to the other creditors; *or* (b) assets of the seller being withdrawn from the creditors; *or* (c) the seller's debts being increased. Moreover, recovery requires that: (X), the seller was, or by the completion of the sale (alone or in combination with another related circumstance) became, insolvent; *and* (Y), the purchaser knew or ought to have known of the seller's insolvency and the circumstances rendering the action improper (a party connected to the obligor is deemed to have such knowledge, unless it can show that it is likely that it neither knew nor ought to have known about the relevant circumstances). Moreover, a general requirement is that the sale has resulted in a disadvantage for the creditors of the seller.

The clawback period is five years from the "relevant date" (broadly the date when a petition for bankruptcy was filed) for unrelated parties. For transactions between related parties, there are no time constraints.

---

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

---

There are no provisions governing substantive consolidation under Swedish law.

---

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Sweden, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) sales of receivables that only come into existence after the commencement of such proceedings?**

---

If an agreement regarding the sale of receivables (existing or future) has been entered into between the seller and the purchaser, but the sale has not been completed prior to insolvency proceedings against the seller being initiated, such agreement is not automatically terminated. The bankruptcy estate may, at the bankruptcy receiver's discretion, choose to become a party to the agreement and complete the sale or to refrain from fulfilling the agreement. If the bankruptcy estate does not enter into the agreement within a reasonable time after the other party's demand, the purchaser may terminate the contract. The purchaser may then enter into new negotiations with the bankruptcy receiver regarding the acquisition as the task of the receiver is to sell the assets of the bankruptcy estate (with a requirement to seek to obtain the highest possible proceeds).

**6.6 Effect of Limited Recourse Provisions.** If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?

Provided that limited recourse provisions, which effectively limit all claims to the assets of the debtor from time to time, are included in all of the debtor's contracts, the debtor would in theory not be able to be declared insolvent. Whether the debtor can or cannot pay its debts as they fall due, and such incapacity is not merely temporary (which is the insolvency test under Swedish law) will be a matter of fact and not of law.

## 7 Special Rules

**7.1 Securitisation Law.** Is there a special securitisation law (and/or special provisions in other laws) in Sweden establishing a legal framework for securitisation transactions? If so, what are the basics?

In principle no, but the Swedish Capital Adequacy and Large Exposures Act includes provisions regarding capital adequacy and exposure requirements in connection with securitisation, and please also refer to the licence requirements in question 8.1.

**7.2 Securitisation Entities.** Does Sweden have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

No, but please refer to the licence requirements in question 8.1.

**7.3 Limited-Recourse Clause.** Will a court in Sweden give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

Yes, provided that it is deemed to have been entered into on arm's length terms.

**7.4 Non-Petition Clause.** Will a court in Sweden give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Yes, provided that it is deemed to have been entered into on arm's length terms.

**7.5 Priority of Payments "Waterfall".** Will a court in Sweden give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Yes, outside of bankruptcy. In the case of bankruptcy, the receiver may not be bound by such contractual provisions, in which case you may have to rely on contractual claims against the other parties receiving payments in breach of that specified order.

**7.6 Independent Director.** Will a court in Sweden give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

The directors owe certain fiduciary duties towards the company. To the extent that the provision forces a director to act in breach of such fiduciary duties, such provision may be held invalid by a Swedish court. A petition to commence insolvency proceedings can be made either by an unsecured creditor or by majority decision by the board of directors.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc.** Assuming that the purchaser does no other business in Sweden, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Sweden? Does the answer to the preceding question change if the purchaser does business with other sellers in Sweden?

Swedish law stipulates that "financing business" (Sw. *finansieringsrörelse*) requires a licence from the FSA. A company is deemed to be conducting "financing business" if it intends (i) to receive repayable funds from the public (directly or indirectly), and (ii) to provide credit, provide security for credit or, for financing purposes, to acquire receivables or lease movable property. Accordingly, a company that performs securitisation transactions will, as a main rule, be deemed to be conducting "financing business". However, one important exemption to the main rule is that companies that will not raise funds on a "regular basis" (which is believed to mean up to three to five issuances of notes) are not required to obtain a licence.

Furthermore, the FSA is of the opinion that if the notes are issued under an approved prospectus, or if the Swedish Financial Instruments Trading Act provides that no prospectus is required for the offering, a licence is not needed, regardless of whether the company will raise funds on a regular basis or not. However, we recommend that this is pre-cleared with the FSA.

Please note that the above applies in relation to a Swedish purchaser. Should the purchaser be a non-Swedish entity, the FSA should not have jurisdiction over the purchaser and the above rules should not apply (unless the purchaser has a permanent business establishment in Sweden).

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

Subject to the factual circumstances of each case, the seller replacement servicer could require a collection licence under the Swedish Debt Recovery Act. As a main rule under the act, such a licence is required for enforcing and collecting receivables on behalf of another person, or for collecting receivables which have been taken over for collection. In any case, a third party servicer will require a licence. Companies under the supervision of the FSA and attorneys at law are exempted from the requirement.

**8.3 Data Protection. Does Sweden have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

The Swedish Personal Data Act applies to all processing (directly and indirectly) of personal data relating to private individuals, including consumer debtors. "Processing" in this context includes, among other things, collection and transfer of personal data, and the processing must be in accordance with the requirements under the act. Generally the affected individual has to consent to the processing. One exemption is if the processor's (or a third party's) interest outweighs the individual's interest in protection of his or her personal data.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Sweden? Briefly, what is required?**

Consumer credits are subject to certain mandatory rules under the Swedish Consumer Credit Act, which will be applicable also for a company acquiring such assets. Such act is further described in question 1.2.

**8.5 Currency Restrictions. Does Sweden have laws restricting the exchange of Swedish currency for other currencies or the making of payments in Swedish currency to persons outside the country?**

No, there are no such currency restrictions, subject to any sanctions imposed by the United Nations and/or the European Union.

## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Sweden? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

There are no withholding taxes in Sweden on interest payments or other payments on receivables in respect of securitisation. Whether

or not a discount or a deferred purchase price would be recharacterised as interest is of no relevance in this context.

**9.2 Seller Tax Accounting. Does Sweden require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

No, it does not.

**9.3 Stamp Duty, etc. Does Sweden impose stamp duty or other documentary taxes on sales of receivables?**

No, it does not.

**9.4 Value Added Taxes. Does Sweden impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

In general, Sweden imposes value added tax ("VAT") on sales of goods and services. The standard VAT rate is 25 per cent. VAT is not imposed on sales of financial assets such as receivables, but factoring service and services conducted by a collection agent are subject to VAT.

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

No, it will not.

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Sweden, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Sweden?**

The purchaser is not liable to income tax in Sweden, unless it is considered to have a permanent establishment in Sweden. That can generally be avoided in a securitisation transaction where the purchaser is a non-Swedish entity and the seller acts in its own name and in the ordinary course of its business.

**Stefan de Hevesy**

Advokatfirman Vinge KB  
Smålandsgatan 20  
111 87 Stockholm  
Sweden

Tel: +46 10 614 3181  
Fax: +46 10 614 3190  
Email: [stefan.hevesy@vinge.se](mailto:stefan.hevesy@vinge.se)  
URL: [www.vinge.com](http://www.vinge.com)

Stefan de Hevesy has extensive legal experience within the area of finance law, including securitisation, covered bonds, leasing, acquisition financing, property financing, restructuring and property related M & A. Stefan de Hevesy was involved in the first securitisations made by Swedish originators in the 1990s and has since then acted for both originators and arrangers.

Ranked as *Senior Statesman* for Banking and Finance and Capital Markets: Debt, Chambers Global, 2014; and Leading Individual for Banking and Finance and Capital Markets, The Legal 500, 2013.

*"A key player on the debt capital markets team, Stefan de Hevesy advises issuers, originators, dealers and arrangers on a range of transactions including domestic and international securitisations and bond issues."* Chambers Global - Capital Markets: Debt, 2014.

*"Stefan de Hevesy is a senior figure in the team and an immensely experienced finance lawyer. He is widely praised for his 'swift, efficient service and excellent manner'."* Chambers Global - Banking and Finance, 2014.

Stefan's full professional profile is available at:

<http://www.vinge.com/sv/medarbetare/Stockholm/Delagare/de-Hevesy-Stefan/>.

**Albert Wällgren**

Advokatfirman Vinge KB  
Smålandsgatan 20  
111 87 Stockholm  
Sweden

Tel: +46 10 614 3020  
Fax: +46 10 614 3190  
Email: [albert.wallgren@vinge.se](mailto:albert.wallgren@vinge.se)  
URL: [www.vinge.com](http://www.vinge.com)

As a member of the Vinge banking and finance team, Albert Wällgren has experience in advising high profile Swedish and international clients such as private equity firms, banks and other financial institutions, acting for borrowers, lenders and arrangers in various types of financing transactions, including acquisition financing, bond issues, asset-backed financing and derivative transactions. Albert has several years of knowledge and experience from work within the sector of debt portfolio transfers and debt collection. Albert further has extensive experience from cross-border financing transactions, both from Vinge and from recent secondment with the European Investment Bank (EIB) in Luxembourg.

Albert's full professional profile is available at:

<http://www.vinge.com/sv/medarbetare/Stockholm/Bitradande-jurister/Wallgren-Albert/>.

# VINGE

For a long time, Vinge has been one of the leading Swedish law firms in the fields of banking and finance and capital markets. With a large number of skilled lawyers practising within the banking and finance sectors, we possess the capacity and experience to handle every type of transaction from major, complex international transactions to smaller, local matters. Vinge is consistently ranked among the leading law firms in the area of banking and financing, including securitisations, and with our vast experience and market knowledge, Vinge is able to offer the highest quality advice with strong commercial focus on all aspects of banking and financing transactions, including securitisations.

# Switzerland

Oliver Widmer



Urs Klöti



Pestalozzi Attorneys at Law Ltd

## 1 Receivables Contracts

- 1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

In order to create an enforceable debt obligation of the obligor, it is not required that the sales of goods or services are evidenced by a formal receivables contract. Under the contract rules of the Swiss Code of Obligations (CO), a contract may not only be entered into in writing, but also orally or based on the implied conduct of the parties (behaviour). By taking the parties’ conduct into account, an invoice may constitute evidence of a contract.

- 1.2 Consumer Protections. Do Switzerland’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

The Swiss Consumer Credit Act and its implementing ordinance provide that the maximum interest rate (including commissions and other costs) for consumer credit (typically loans) may not exceed 15 per cent *per annum*. Outside the applicability of the Consumer Credit Act, federal case law provides for a maximum interest rate of 18 per cent *per annum*.

If an obligor is in default in discharging the receivables of the seller, the receivables bear a default interest of 5 per cent *per annum* (Art. 104 CO).

The obligor has the right to cancel the consumer credit (loan) within 7 days after the conclusion of the consumer credit contract. Cancellation must be made in writing. Another noteworthy right of the consumer is that claims for payment against consumers may only be brought before the competent court in the country of residence of the consumers.

- 1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

There are no different requirements and laws relating to receivables of

the government and government agencies. However, receivables against the government and government agencies relating to public assets (*Verwaltungsvermögen*) are protected against enforcement by third parties. Receivables relating to private assets (*Finanzvermögen*) of the government and government agencies, on the other hand, are not immune against enforcement.

## 2 Choice of Law - Receivables Contracts

- 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Switzerland that will determine the governing law of the contract?**

The Swiss Statute on Private International Law (PIL) of 18 December 1987 provides that, in the absence of an explicit choice of law, the contract will be governed by the law of the state with which it is “more closely connected” (Art. 117 para. 1 PIL).

It is presumed that the closest connection exists with the state where the party called upon to provide the ‘characteristic performance’ of the contract has – at the time of conclusion of the contract – its ordinary residence or, if the contract was concluded in the exercise of a professional or commercial activity, where such party has its place of business. In particular, the following shall be considered the characteristic obligation:

- the obligation of the alienator, in contracts of alienation;
- the obligation of the party transferring the use of a thing or a right, in the case of contracts concerning the use of a thing or a right;
- the service performed, in the case of mandates, work and labour contracts, and similar service contracts;
- the obligation of the custodian, in custodial contracts; and
- the obligation of the guarantor or the surety, in guaranty or surety contracts.

There are specific provisions regarding certain types of contracts that precede these rules as *leges speciales*. In particular the following contracts are involved:

- The sale of movable property is governed by The Hague Convention of 15 June 1955 on the Law Applicable to International Sales or Movable Property. However, this provision shall not apply within the scope of the United Nations Convention on the International Sales of Goods (CISG) of 11 April 1980, if the application has not explicitly been excluded by the parties (see question 2.4 below).
- Contracts concerning real property (or its use) are basically governed by the law of the state in which the property is located. A choice of law by the parties is permitted.

However, it has to be noted that the form of the contract is governed by the law of the state in which the real property is located unless that law permits the application of another law. In case of real property located in Switzerland, the form shall be governed by Swiss law.

- Contracts for a performance relating to normal consumption, which is intended for a consumer's or for his family's personal use and not connected with his professional or commercial activities, are governed by the law of the state in which the consumer has his ordinary residence if (i) the offeror has received the order in that state, (ii) in that state, the conclusion of the contract was preceded by an offer or advertisement and the consumer has carried out the legal acts necessary for the conclusion of the contract in that state, or (iii) the offeror has prompted the consumer to go abroad and deliver his order there. In such cases, a choice of law by the parties is excluded.
- Employment contracts are governed by the law of the state in which the employee has his ordinary place of work. If the employee ordinarily works in several states, the employment contract is governed by the law of the state in which the employer's business establishment or, in the absence of such establishment, his domicile or ordinary residence, is located. However, the parties may subject the employment contract to the law of the state in which the employee has his ordinary residence, or in which the employer has his business establishment, domicile, or ordinary residence.
- Contracts concerning intellectual property are governed by the law of the state in which the party transferring the intellectual property right or granting the use thereof has its ordinary residence. A choice of law is permitted. However, contracts between employers and employees in the course of performance of the employment contract shall be subject to the law governing the employment contract.

## 2.2 Base Case. If the seller and the obligor are both resident in Switzerland, and the transactions giving rise to the receivables and the payment of the receivables take place in Switzerland, and the seller and the obligor choose the law of Switzerland to govern the receivables contract, is there any reason why a court in Switzerland would not give effect to their choice of law?

No, a court in Switzerland should give effect to their choice of law.

## 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Switzerland but the obligor is not, or if the obligor is resident in Switzerland but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Switzerland give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

The Swiss PIL is based on the general principle of the parties' autonomy to contract. This principle includes the right of the contracting parties to freely choose the governing law. For the purpose of this general principle, the Swiss PIL provides that contracts are subject to the law chosen by the parties (Art. 116 para. 1 PIL). This applies also where only one of the parties is located in Switzerland and the parties chose the foreign law of the party located outside Switzerland.

However, there are several general restrictions and limitations to the right to freely elect the governing law under Swiss law:

- (a) First, the election of a foreign law has to relate to an international matter. With regard to internationality, the determination as to whether there is an international element or not is to be made on a case-by-case basis. However, Swiss courts are rather reluctant to disregard the parties' conscious election of foreign law if the case at hand has at least some international element.
- (b) The application of provisions of foreign law is precluded if it would produce a result which is incompatible with Swiss public policy (*ordre public*). Pursuant to the jurisprudence of the Swiss Federal Supreme Court, an extremely unfair result is required to overrule Swiss public policy. However, the escape clause of the Swiss public policy applies only if there is a link to Switzerland in the particular case. The main areas of application of this clause are in the law of persons and in family law.
- (c) The election of foreign law is not recognised in case of mandatory provisions of Swiss law. For certain types of contracts, the PIL contains mandatory rules regarding the choice of the governing law. As to commercial relationships, the election of foreign law can be excluded or limited, in particular in the area of consumer protection, employment laws and product liability (see question 2.1 above).

## 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Switzerland?

Yes. Switzerland adopted the UN Convention on Contracts for the International Sale of Goods (CISG) of 11 April 1980 as per 1 March 1991. Pursuant to Art. 1 para. 1 CISG, the convention applies to contracts of sale of goods between parties whose places of business are in different states: (i) when the states are contracting states; or (ii) when the rules of private international law lead to the application of the law of a contracting state.

The CISG provides the substantive sales law for contracts regarding the international sale of goods, insofar as it contains provisions settling such matters. The rules of the convention supersede national Swiss law. However, the convention itself does not regulate procedural matters and, consequently, the CISG does not provide for jurisdiction. The jurisdiction of the competent court is to be determined according to the rules of private international law of the forum state.

Since the requirements of the CISG (e.g. Art. 1 para. 1 *lit. a*) are met, the convention finds direct application without recourse to the Swiss rules on conflict of laws. However, the parties may agree to exclude the application of the CISG, as it is often done in practice.

## 3 Choice of Law - Receivables Purchase Agreement

### 3.1 Base Case. Does Switzerland's law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Switzerland's laws or foreign laws)?

No. The parties to a receivables purchase agreement are free to choose which law shall govern their contract, irrespective of the law governing the receivables themselves.

However, certain specifics regarding performance (e.g. transfer and perfection) of the receivables will be subject to the law of the state in which they actually occur, irrespective of the law governing the receivables contract (Art. 125 PIL). In addition, the assignment of the receivables, however, is typically governed by the law governing the receivables themselves.



**3.2 Example 1: If (a) the seller and the obligor are located in Switzerland, (b) the receivable is governed by the law of Switzerland, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Switzerland to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Switzerland, will a court in Switzerland recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?**

Yes. Under Swiss conflict of law provisions, the parties to a receivables contract are free to choose which law shall govern their contract, irrespective of the law governing the receivables themselves. This applies whether the purchaser, the seller or the obligor are in different countries or not and whether the parties choose a jurisdiction in which one of them is located or not. In particular, a court in Switzerland permits the seller, the purchaser and the obligor to choose the law of Switzerland to govern the receivables sale if only one of the seller, the purchaser or the obligor is resident in Switzerland.

A court in Switzerland will recognise such a sale as being effective against the seller, the obligor and other third parties, provided no mandatory provisions of law other than chosen by the parties would be violated.

However, certain specifics regarding performance (e.g. transfer and perfection) of the receivables will be subject to the law of the state in which they actually occur, irrespective of the law governing the receivables contract (Art. 125 PIL). In addition, the assignment of the receivables, however, is typically governed by the law governing the receivables themselves.

**3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Switzerland, will a court in Switzerland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?**

Yes. Please refer to question 3.2. A court in Switzerland will recognise such a sale as being effective against the seller, the obligor and other third parties, provided no mandatory provisions of law other than those chosen by the parties would be violated.

However, certain specifics regarding performance (e.g. transfer and perfection) of the receivables will be subject to the law of the state in which they actually occur, irrespective of the law governing the receivables contract (Art. 125 PIL). In addition, the assignment of the receivables, however, is typically governed by the law governing the receivables themselves.

**3.4 Example 3: If (a) the seller is located in Switzerland but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Switzerland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Switzerland own sale requirements?**

Yes. Please refer to question 3.2. A court in Switzerland will

recognise such a sale as being effective against the seller, the obligor and other third parties, provided no mandatory provisions of law other than those chosen by the parties would be violated.

However, certain specifics regarding performance (e.g. transfer and perfection) of the receivables will be subject to the law of the state in which they actually occur, irrespective of the law governing the receivables contract (Art. 125 PIL).

**3.5 Example 4: If (a) the obligor is located in Switzerland but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Switzerland recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Switzerland own sale requirements?**

Yes. Please refer to question 3.2. A court in Switzerland will recognise such a sale as being effective against the seller, the obligor and other third parties, provided no mandatory provisions of law other than those chosen by the parties would be violated.

However, certain specifics regarding performance (e.g. transfer and perfection) of the receivables will be subject to the law of the state in which they actually occur, irrespective of the law governing the receivables contract (Art. 125 PIL).

**3.6 Example 5: If (a) the seller is located in Switzerland (irrespective of the obligor's location), (b) the receivable is governed by the law of Switzerland, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Switzerland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Switzerland and any third party creditor or insolvency administrator of any such obligor)?**

Yes. Please refer to question 3.2. A court in Switzerland will recognise such a sale as being effective against the seller, the obligor and other third parties, provided no mandatory provisions of law other than those chosen by the parties would be violated.

However, certain specifics regarding performance (e.g. transfer and perfection) of the receivables will be subject to the law of the state in which they actually occur, irrespective of the law governing the receivables contract (Art. 125 PIL).

In addition, the assignment of the receivables is typically governed by the law governing the receivables themselves.

## 4 Asset Sales

**4.1 Sale Methods Generally. In Switzerland what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

The seller:

- (i) enters into a purchase contract (which does not necessarily have to be in writing) with the purchaser; and

- (ii) assigns the receivables against the respective obligor(s) to the purchaser.

In order for an assignment to be effective, the claims must be assignable, i.e. the assignment must not be prohibited by law, contractual non-assignment clauses or the nature of the receivables. The declaration of assignment must be made in writing and signed by at least the assignor. It is common practice that the parties enter into an assignment agreement signed by both parties. Notification to the respective obligor is not required in order for the assignment to be valid. However, until the obligor is notified of the assignment, the *bona fide* obligor may validly discharge his obligations by making payments to the assignor.

The customary terminology is a sale and assignment of receivables.

---

#### 4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

---

The existence of a purchase agreement and an assignment in writing is required for an effective sale and assignment of receivables. Perfection does not require that the obligor be notified of the assignment. However, as long as the obligor is not notified of the assignment, he may validly discharge his obligations if he makes payments to the assignor in good faith.

A good faith purchaser/assignee of receivables does not exist (exceptions apply for bills of exchange/securities). If the assignor assigns the same receivables several times to different parties, the first assignee acquires first rights. After the first valid assignment, the assignor loses his right to dispose of said receivables and cannot validly assign them to any other party. The first assignor becomes the owner of the receivables. However, the obligor is protected if he has been notified of the second assignment only and makes payment to the alleged (later) assignee. The first and rightful assignee is then entitled to raise a claim for unjust enrichment and damages against the second assignee.

---

#### 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

---

The perfection of promissory notes (*einfacher Schuldschein*) relating to receivables requires a valid assignment.

With regard to mortgage-backed loans, the sale and transfer of receivables secured by a mortgage (*Grundpfandverschreibung*) as a right *in rem* over the underlying encumbered land to the purchaser will be effected by way of assignment. Such assignment is effective and perfected without notice to the respective obligors or filings with the competent land registry and will include the security over the encumbered land (which passes to the purchaser *ex lege* as ancillary right of the assigned receivables). Although no filings or registrations with the land registry are necessary for the perfection of the sale and transfer of receivables, purchasers will typically wish to be registered as creditors in the creditors' register with the effect that insurers may not validly discharge their payment obligations to the land owner without the consent of the registered creditor.

In case a mortgage certificate (*Schuldbrief*) was provided as security by the obligor to the lender and (i) transferred to the latter by way of security (*Sicherungsübereignung*), the lender/originator selling the receivables (loan claims) to the special purpose vehicle (SPV) may transfer the security to the SPV by transferring the mortgage certificate to the SPV by way of security (*Sicherungsübereignung*) or pledge (*Pfand*). In the case of bearer mortgage certificates, physical delivery is required and, in the case of registered mortgage certificates, physical delivery and endorsement are necessary. If instead, (ii) the mortgage certificate was pledged to the lender, the security passes to the SPV *ex lege* as an ancillary right at the time of assignment of the loan claim.

The transfer of marketable debt securities requires, in case of bearer securities (*Inhaberpapiere*), physical delivery of the securities and in case of registered securities (*Ordrepapiere*), physical delivery and endorsement to the purchaser. Special rules apply for book-entry securities.

---

#### 4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

---

A notification of the obligor is not required for the sale/assignment to be effective. No other formalities or filings with any administrative or governmental authority in Switzerland are required in order to render the sale/assignment of receivables effective. While the validity and effectiveness of the sale/assignment is not dependent on the notification to the obligor, the latter may validly discharge its obligations by payment to the seller/assignor, as long as the assignment has not been notified to the obligor.

In order to validly effect a sale/assignment of receivables, the obligor's consent to the sale/assignment is not required, subject to the following exceptions, the contract between the seller/assignor and the obligor: (i) contains a prohibition of assignment or expressly provides for the assignment to be subject to the consent of the obligor; (ii) is considered to have been entered into *intuitu personam*; or (iii) is subject to Swiss banking secrecy. The receivables contract between the seller/assignor and obligor does not have to expressly permit the assignment of claims.

When bankruptcy proceedings regarding the seller/assignor are opened, notification of the obligor (by the purchaser/assignee) is highly recommended. Upon notification, the obligor can only validly discharge his obligations by making payments to the assignee. If he is not notified in due time and pays the bankrupt assignor, he is validly discharged.

If the obligor becomes bankrupt, the obligor loses his capacity to dispose of his assets. All assets form part of the bankrupt estate. Thus, when notified of the assignment, the obligor is not entitled to make payments to the assignee.

**4.5 Notice Mechanics.** If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There is no requirement as to the form of the notice. One should, however, ensure that the obligor received the notice by sending the notice through adequate means (registered letter, courier, etc.). There is no limit beyond which notice is ineffective for Swiss law governed receivables against obligors domiciled in Switzerland. The notice applies to all (including future) receivables. For the effects of bankruptcy proceedings on future receivables, please refer to questions 6.1 to 6.5.

**4.6 Restrictions on Assignment - General Interpretation.** Will a restriction in a receivables contract to the effect that “None of the [seller’s] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]” be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says “This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]” (i.e., the restriction does not refer to rights or obligations)?

Yes, as mentioned above (under question 4.3 above), should a contract contain any such restriction, the seller can only assign subject to the obligor’s consent.

**4.7 Restrictions on Assignment; Liability to Obligor.** If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Switzerland? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Switzerland recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Yes, such restrictions are generally enforceable in Switzerland. The obligor cannot raise, against a third person who has acquired the claim in reliance upon a written acknowledgment of indebtedness which does not contain a prohibition of assignment, the defence that the assignment has been precluded by agreement. The assignment of a restricted claim is invalid and remains with the seller. A seller can become liable for breach of contract or by tort.

**4.8 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells *all* of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

Under generally applicable principles of the Code of Obligations, the receivables must be identified or identifiable. Whether receivables are identifiable or not must be determined on a case-by-case basis. There are no standardised objective characteristics. With regard to future receivables (receivables which come into existence after the assignment), the Federal Supreme Court held that they must be identified or identifiable regarding the obligor, legal ground and amount. This, in particular, holds true in case the seller sells all of his receivables to the purchaser, including future receivables (*Globalzession*). It is, however, advisable to identify the receivables to be sold either in advance, or with respect to future receivables, periodically to evidence the receivables that have come into existence. Likewise, one could question whether it is sufficient identification of receivables if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors.

**4.9 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

The “true sale” principle aims to ensure that the sale of assets from the seller to the purchaser is made on a “no recourse” basis both from a legal and accounting perspective. The Swiss legal framework is able to satisfy all requirements which result from this concept although it is not a recognised legal concept under Swiss law (but is an accounting and tax concept). The question as to whether or not the “true sale” requirement is met or not will widely depend on the economic conditions and circumstances of each individual case. The fact that the seller retains a credit risk, or an interest rate risk, or the control of the collection of the receivables is, as such, not a factor which may jeopardise perfection. The factors which may put a true sale at risk would be circumstances where the price is not determined at arm’s length so that there is a risk of challenge by third party creditors requesting a “revocation” in the event of insolvency of the seller on the grounds that they have been defrauded by the sale of the receivables. The risk of such a claim is generally considered to be excluded if the sale of the receivables is made at market value.

**4.10 Continuous Sales of Receivables.** Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Swiss law provides for the assignment of claims on a revolving basis (as and when they arise). The question of whether or not

receivables that come into existence after the date of the seller's bankruptcy can be validly assigned to the assignee, is not addressed under Swiss law (please refer to question 4.8).

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?**

It is possible under Swiss law to sell/assign future claims (i.e. claims that come into existence after the date of the receivables purchase/assignment agreement) provided that they are sufficiently identified or identifiable as to the obligor, legal ground and amount (also see question 4.8). There is no further requirement for the sale and the assignment of future receivables to be valid and enforceable under Swiss law. There is no specific Federal Supreme Court decision regarding the enforceability of future receivables that have arisen (rather than matured only) after the commencement of Swiss bankruptcy proceedings with regard to the seller/assignor.

Since the assignor loses his capacity to dispose of the assigned claims upon the adjudication of bankruptcy/insolvency proceedings, receivables that arise after the seller's insolvency may not be validly assigned and the competent insolvency official may challenge the validity of the transfer of future claims.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

The assignment of receivables includes so-called ancillary rights. Some security interests constitute such ancillary rights, e.g. a pledge. Hence, when receivables that are secured by a pledge are transferred, the pledge automatically passes to the assignee *ex lege*. However, other security interests such as mortgage certificates (*Schuldbriefe*) do not constitute ancillary rights and do not pass *ex lege*. Hence, when the receivables secured by a mortgage certificate are assigned to the purchaser/assignee, specific action is required in order for the security interest to pass to the assignee. Bearer mortgage certificates must be transferred by physical delivery and registered mortgage certificates by physical delivery and endorsement. Please also refer to question 4.3.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

The obligor can set-off any amounts against the seller and any subsequent purchaser. If the obligor sets-off a claim against the seller, the seller becomes liable to the purchaser/assignee.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Switzerland to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

It is not customary to provide for a 'back-up' security interest. However, the parties are at liberty to choose a back-up security.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Switzerland, and for such security interest to be perfected?**

Security interest in receivables may be established by:

- (i) assignment by way of security (*Sicherungszession*); or
- (ii) pledge (*Verpfändung*).

Assignment by way of security is the more commonly used form to create security and is preferable for the assignee. In particular, it leaves more flexibility in terms of available foreclosure proceedings (when the purchaser/assignor becomes bankrupt) and will *de facto* lead to the earlier completion of foreclosure proceedings. The two forms of security are briefly described below.

**Assignment by way of security (Art. 164 CO):** when receivables are assigned, the assignee becomes the owner of the receivables. Even if, technically, the assignee could dispose of the assigned receivables freely due to his full ownership interest in the receivables, his right to dispose of the receivables is contractually limited; he is only allowed to dispose of the receivables in accordance with the underlying security assignment agreement and to realise the security for the secured obligations.

**Pledge (Art. 899 *et seqq.* of the Civil Code (CC)):** claims and other rights can be pledged if they are assignable. Claims are assignable unless the assignment is prohibited by law, contractual non-assignment stipulations or due to the nature of the receivables. The only formal requirement is that the pledge agreement be in writing. Neither the validity nor the perfection of the pledge depend on the notification of the debtor.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Switzerland to grant and perfect a security interest in purchased receivables governed by the laws of Switzerland and the related security?**

Please refer to question 5.2.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Switzerland, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Switzerland or must additional steps be taken in Switzerland?**

Under the Swiss conflict of laws rules, the purchaser/parties is/are free to choose the law under which the purchaser grants a security interest. If the security interest is validly perfected under the relevant foreign law, the security interest will generally be treated as valid and perfected under Swiss law. Pursuant to the Swiss

conflicts of laws rules, the following special rules apply to the debtors or third parties, respectively, in relation to the assigned or pledged receivables:

**Assigned receivables:** the assignor and the assignee's choice of a foreign law may not be asserted against, and will not be binding upon, the debtor without his consent if the law governing the receivables is different from the chosen law. In other words, the validity and perfection of the foreign law-governed assignment cannot be asserted against the debtor, unless the debtor consents to the foreign law, or the requirements for a valid and perfected assignment under the laws governing the receivables are met.

**Pledged receivables:** the pledgor and the pledgee's choice of foreign law may not be asserted against, and will not be binding upon: (i) the debtor, if the law governing the receivables is different from the chosen law; and (ii) *bona fide* third parties, such as third party creditors.

Instead, the law governing the receivables will apply to the debtor (unless the debtor consents to the law chosen by the pledgor and pledgee) and the law of the jurisdiction where the pledgee is resident will apply to *bona fide* third parties.

---

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

---

A security interest in marketable debt instruments can be created by way of pledge. The establishment of a pledge in respect of marketable debt securities requires physical delivery of the certificates (in the case of bearer instruments) together with an endorsement (in the case of instruments drawn to the order of a person) or assignment. A security interest can also be established by transfer by way of security (*Sicherungsübereignung*). The same rules apply.

Under Swiss law, neither notification of the debtor (or owner of the encumbered land in case of mortgages) nor registration or filing with a governmental authority is required for the perfection of the pledge.

---

**5.6 Trusts. Does Switzerland recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

---

Substantive Swiss trust law does not exist. Therefore, a trust in its literal sense cannot be set up under Swiss law. Since July 2007, the Hague Convention on the Law Applicable to Trusts and on their Recognition 1985 (Hague Trust Convention) is applicable in Switzerland. The conflict of laws rules have incorporated the Hague Trust Convention into national law and allow for full and complete recognition of foreign trusts in Switzerland.

Collections received by the seller in respect of sold receivables can be held in a separate account of the seller apart from his own assets until the collection proceeds are turned over to the purchaser. After the assignment of receivables, the assignee is the rightful owner of the receivable. Therefore, the assignee has to authorise the assignor to collect the receivables (in his own name) on behalf of the assignee. To ensure that the debtors transfer the funds to a separate account of the seller, the receivables contract between the seller and the debtors has to specify such separate account.

---

**5.7 Bank Accounts. Does Switzerland recognise escrow accounts? Can security be taken over a bank account located in Switzerland? If so, what is the typical method? Would courts in Switzerland recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Switzerland?**

---

Switzerland recognises escrow accounts. It is also possible to create a security interest over bank accounts located in Switzerland. There are two possibilities: bank account assets and claims against the bank relating to the bank account assets can either be: (i) pledged; or (ii) assigned by way of security. A pledge is preferable for the security provider/pledgor since he remains the owner of the bank account assets, whereas an assignment is preferable for the security taker/assignee because he becomes the owner of the bank account assets. He is also in a better position in foreclosure proceedings. For further reference, please see question 5.3.

Pursuant to the Swiss conflict of laws rules, the parties are free to choose the law under which they create a security interest. If the security interest over a Swiss bank account is validly perfected under the relevant foreign law, the security interest will generally be treated as valid and perfected under Swiss law between the parties (security provider and security taker). However, limitations apply in relation to the bank account. Foreign law may not be binding for the bank account. Please refer to question 5.4.

---

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

---

Security over bank accounts is typically taken by way of assignment or by way of a pledge. The object of the assignment or the pledge is, amongst others, the right of the account holder against the account bank to deliver any accounts standing to the credit of the account holder. This means that the secured party controls any cash flowing into the bank account, provided there are no other first priority rights. In particular, the account bank, under its general terms and conditions, has first priority rights. The secured party is further limited so that in case of an assignment of the claims against the bank account (but not in case of a pledge), after the bankruptcy of the account holder, the future claims and cash fall into the bankruptcy estate and the secured party has no control rights over any future cash flowing in the bank account after such a bankruptcy event. Please also see question 6.1 below.

---

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

---

Yes, this is possible. The security agreement provides whether the owner of the account has access to the funds in the account prior to enforcement.

## 6 Insolvency Laws

**6.1 Stay of Action.** If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Switzerland insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Swiss law distinguishes between the sale of existing receivables and the sale of future receivables:

In general, existing receivables validly assigned are bankruptcy remote. This means, in the event of bankruptcy or similar insolvency proceedings against the seller, the existing receivables will not fall within its bankrupt estate. Moreover, the openings of bankruptcy or similar proceedings do not cause an “automatic stay” of such receivables under Swiss law. Accordingly, the purchaser is free to collect, transfer or otherwise exercise his ownership rights over the assigned receivables.

Future receivables are defined as assigned receivables that have not yet come into existence. Such receivables may be assigned under Swiss law if the future claims can be defined with sufficient specificity, whereas the assignment becomes effective upon existence of the assigned receivable. However, a valid assignment of future receivables will cease to be valid if bankruptcy proceedings are opened against the originator of the receivables. The opening of bankruptcy proceedings causes all obligations to fall due, according to Art. 208 para. 1 of the Federal Statute on Debt Enforcement and Bankruptcy (Bankruptcy Act) of 11 April 1889. Pursuant to the current jurisprudence of the Swiss Federal Supreme Court, future receivables are not deemed to have been validly assigned and therefore fall within the bankruptcy estate of the seller in the event of bankruptcy or similar insolvency proceedings against the seller (*Durchgangstheorie*). Regarding the assigned future receivables, the purchaser will be treated as an unsecured creditor ranking equal to all the other unsecured creditors of the bankruptcy seller (mainly in the third class). Although no “automatic stay” applies under Swiss law with respect to future receivables, the purchaser is not entitled to collect, transfer or otherwise exercise ownership rights.

According to the prevailing opinion in Switzerland, the assignment of receivables is linked to the underlying transaction (e.g. the assignment agreement) and therefore only valuable if the sale is perfected. With the opening of bankruptcy proceedings, all seizable assets owned by the debtor at this time, irrespective of where they are situated, form part of the bankruptcy estate. This applies also to controversial receivables.

Immediately upon receipt of the bankruptcy order, the insolvency official raises an inventory of the assets belonging to the bankruptcy estate. If the insolvency official doubts the sale of certain (existing) receivables to be perfected, he lists the receivables in the inventory. Further, the insolvency official has the ability to take all necessary measures for their safeguarding (Art. 221 of the Bankruptcy Act), e.g. a stay collection and enforcement actions until it is determined that the sale is perfected.

According to Swiss law, it makes no difference whether or not the receivables have been assigned for security purposes (*Sicherungscession*) in connection with a secured financing.

**6.2 Insolvency Official’s Powers.** If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

Once bankruptcy proceedings have been opened, claims forming part of the bankruptcy estate can no longer be validly discharged by payment to the debtor (Art. 205 Bankruptcy Act). With regard to future receivables (which fall into the bankruptcy estate of the seller), the competent insolvency official will notify the debtors of the opening of bankruptcy proceedings and inform them that the sole legally valid way of discharging their obligation is by payment to the bankruptcy office. Payment made to the purchaser will not relieve the debtor from its payment obligations, unless it is otherwise received by the bankrupt estate. As to the already existing receivables, the competent insolvency official will not interfere with the exercise of rights, provided that the sale is effective and perfected (see question 6.1 above).

**6.3 Suspect Period (Clawback).** Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Switzerland for (a) transactions between unrelated parties, and (b) transactions between related parties?

The insolvency official can avoid a transaction (*actio pauliana*) under the following circumstances:

- (a) Any relevant transaction which the debtor made during a suspect period of one year before the seizure of assets or the opening of bankruptcy proceedings is voidable. Relevant transactions are gifts and voluntary settlements, as well as transactions equivalent to a gift, e.g. transactions in which the debtor accepted a counter-performance out of proportion to his own or transactions through which the debtor obtained for himself or a third party a life annuity, an endowment, a usufruct or a right of habitation (Art. 286 Bankruptcy Act).
- (b) The insolvency official may avoid the granting of collateral for existing obligations without the obligation to do so, the settlement of a debt of money by unusual means and the payment of an obligation not yet due for payment, provided that (i) the debtor carried them out during a suspect period of one year before the seizure of assets or the opening of bankruptcy proceedings, and (ii) the debtor was, at that time, already insolvent. The transaction is not avoided, however, if the recipient proves that he was unaware, and need not have been aware, of the debtor’s insolvency (Art. 287 Bankruptcy Act).
- (c) Finally, all transactions which the debtor carried out during a suspect period of five years prior to the seizure of assets or the opening of bankruptcy proceedings with the intention, apparent to the other party, of disadvantaging his creditors or of favouring certain of his creditors to the disadvantage of others, are voidable (Art. 288 Bankruptcy Act).

As to the length of the suspect period, Swiss law does not distinguish between transactions between related and unrelated parties.

**6.4 Substantive Consolidation.** Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

As long as the purchaser is legally independent from the seller and is

acting on arm's length terms, the risk of consolidation is quite remote from a Swiss law perspective. The legal concept of a "true sale" is not established in Switzerland (see question 3.4 above). Therefore, no distinction is made between "true sale" and secured financing under Swiss law. However, in a secured financing, the seller may reserve the right to repurchase the assigned receivables from the purchaser. In such a case, the insolvency official may assume that there is no valid assignment of the receivables, which would lead to a *de facto* consolidation. However, such risks can be prevented by a proper wording and structure of the assignment agreement.

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Switzerland, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

Pursuant to the current jurisprudence of the Swiss Federal Supreme Court, the sale of future receivables by way of assignment is not bankruptcy remote (see question 6.1 above). After the opening of bankruptcy proceedings, such receivables fall within the bankruptcy estate of the seller on which the bankruptcy administration (*Konkursverwaltung*) has the exclusive power to dispose. The debtor himself is no longer allowed to dispose of the assets within the bankruptcy estate. Acts by the debtor concerning such assets are deemed to be invalid as against his creditors (Art. 204 para. 1 Bankruptcy Act).

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

Please refer to question 7.3 below.

## 7 Special Rules

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Switzerland establishing a legal framework for securitisation transactions? If so, what are the basics?**

There is no special securitisation law in Switzerland. Regarding the transfer of assets from the originator to the SPV, the provisions of the Code of Obligations are applicable (in particular the provisions regarding sale and assignment).

**7.2 Securitisation Entities. Does Switzerland have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

Switzerland does not have any such special laws for SPVs. Stock corporations and limited liability companies are available for the establishment of an SPV. The requirements for the establishment and management of an SPV, as well as the status of directors and shareholders, are set forth in the respective statutory provisions applicable to stock corporations and limited liability companies.

**7.3 Limited-Recourse Clause. Will a court in Switzerland give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

A court in Switzerland might not give effect to a contractual provision alone limiting the recourse of parties to available assets. The whole transaction as a whole must be structured in a way that the "no recourse" basis is possible (please refer to question 4.9).

**7.4 Non-Petition Clause. Will a court in Switzerland give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

The principle of liberty of contracts governs Swiss law. The parties are thus at liberty to enter into an agreement waiving the right to take legal action against the SPV. Such non-petition clauses are enforceable, subject to the following limitations: a party may not validly waive its rights under compulsory provisions of Swiss law or in a way that would be against "*bonos mores*" (Art. 27 CC). Further, such a waiver may be subject to challenge in the case of bankruptcy of one of the parties who has waived his rights against the SPV, in accordance with the limitations which result generally from Swiss bankruptcy law.

**7.5 Priority of Payments "Waterfall". Will a court in Switzerland give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

It is possible to contractually agree on a certain order. There is no reason why a court should not uphold such provision, whether agreed under Swiss law or any other (applicable) law, unless such order would clearly be against public policy. In case of a bankruptcy, however, the creditors will be grouped in three main classes depending on the type of creditor, and the bankruptcy administrator will not consider such contractually agreed provisions (unless the subordination is made with respect to all other creditors). However, in the internal relationship between the parties, a contractual provision relating to a certain order is enforceable (in court) between the parties in question.

**7.6 Independent Director. Will a court in Switzerland give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

As a principle, there is no such contractual subordination that a court must give effect to, apart from in case of a specific subordination where a creditor subordinates its claims against the claims of all other creditors.

## 8 Regulatory Issues

### 8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Switzerland, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Switzerland? Does the answer to the preceding question change if the purchaser does business with other sellers in Switzerland?

The mere purchasing, ownership or collecting of receivables will neither require a foreign purchaser to do business or obtain any licence in Switzerland nor is such a purchaser qualified as a financial institution (e.g. securities dealer, financial intermediary, investment fund, bank, insurer) under Swiss law.

This analysis changes only if the purchaser conducts a business in Switzerland that requires a licence. The mere fact that the purchaser does business with other sellers in Switzerland does not change this analysis.

### 8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

The mere purchasing, enforcing or collecting of the sold receivables by the seller (servicing) does not require the seller to obtain any licence in Switzerland. The same applies to a third party replacement servicer.

### 8.3 Data Protection. Does Switzerland have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

In Switzerland, the processing of information is mainly regulated in the Federal Act on Data Protection (Data Protection Act) of 19 June 1992. The Data Protection Act applies to the processing of data pertaining to natural persons and corporations by private persons and federal bodies. However, it does not apply to personal data that is processed by a natural person exclusively for personal use and which is not disclosed to outsiders. Data that does not qualify as 'sensitive personal data' or 'personality profiles' under the Swiss Data Protection Act can be communicated without the consent of the debtor (Art. 4 para. 5 *e contrario* Data Protection Act).

The Data Protection Act contains a special regulation relating to cross-border disclosure. Thus, personal data may not be disclosed abroad if the privacy of the data subjects would be seriously endangered thereby, in particular due to the absence of legislation that guarantees adequate protection. In the absence of such legislation, disclosure of personal data abroad is subject to various restrictions, including the following: (i) sufficient safeguards (in particular contractual clauses) shall ensure an adequate level of protection abroad; (ii) the data subject must have consented in the specific case; and (iii) the processing shall be directly connected with the conclusion or the performance of a contract and the personal data shall be that of a contractual party (Art. 6 Data Protection Act).

The use or dissemination of data by Swiss banks requires special precautions due to Swiss banking secrecy. Swiss banking secrecy is based on the contractual relationship between the bank and its clients, e.g. the bank's loyalty as an agent to the client as principal, the bank's obligation not to contravene the client's privacy rights and Art. 47 of the Swiss Federal Act on Banks and Savings Institutions (Banking Act) of 8 November 1934 which makes the violation of banking secrecy a criminal offence.

Swiss banking secrecy imposes an obligation upon the bank, their executive bodies and their employees to treat any client-related information confidentially so as to avoid any disclosure of information potentially harmful to a client's interests. However, a client's right to privacy does not mean that Swiss banks do not need to know the identity of their clients. Moreover, Swiss banks are obliged to identify each of their contractual partners and specifically the beneficial owner of the assets involved in any business relationship. Thus, it has to be noted that there are no 'anonymous accounts' in Switzerland as regards the bank's duty to identify their clients. This banking secrecy has never been absolute, and the obligation to secure their client's privacy does not dispense banks from federal and cantonal disclosure obligations. In particular, legal assistance is granted in the event of tax fraud.

The Data Protection Act and the bank secrecy rules apply both to individuals and enterprises.

### 8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Switzerland? Briefly, what is required?

The Federal Act on Consumer Credit of 23 March 2001 (Consumer Credit Act) applies only to certain agreements between lenders and consumers, such as loans not secured by mortgages or usual guarantees, loans for amounts between CHF 500 and CHF 80,000 or short-term loans (Art. 7 para. 1 *lit. e contrario* Consumer Credit Act).

Agreements under the Consumer Credit Act must be concluded in writing. It has to be noted that the Consumer Credit Act basically allows the consumer to terminate his loan at any time by repaying the outstanding amount. Such an early termination allows the consumer to retrieve a part of the costs of his loan (Art. 17 para. 2 Consumer Credit Act).

### 8.5 Currency Restrictions. Does Switzerland have laws restricting the exchange of Switzerland's currency for other currencies or the making of payments in Switzerland's currency to persons outside the country?

The Federal Act on Consumer Credit of 23 March 2001 (Consumer Credit Act) applies only to certain agreements between lenders and consumers, such as loans not secured by mortgages or usual guarantees, loans for amounts between CHF 500 and CHF 80,000 or short-term loans (Art. 7 para. 1 *lit. e contrario* Consumer Credit Act).

Agreements under the Consumer Credit Act must be concluded in writing. It has to be noted that the Consumer Credit Act basically allows the consumer to terminate his loan at any time by repaying the outstanding amount. Such an early termination allows the consumer to retrieve a part of the costs of his loan (Art. 17 para. 2 Consumer Credit Act).



## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Switzerland? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

Payments by a Swiss debtor are, in general, not subject to Swiss withholding tax. However, interest payments may be subject to Swiss withholding tax at a rate of 35 per cent if made under a banking account, bond, debenture or money market paper, or if a Swiss debtor's overall financing activities are regarded, for tax purposes, as so-called "collective fund raising". In addition, interest payments made to non-Swiss lenders are subject to a withholding tax at source if the debt is secured by mortgages in Swiss real estate. A deferred purchase price could indeed be recharacterised as interest.

**9.2 Seller Tax Accounting. Does Switzerland require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

No. Under Swiss law, there is, to date, no specific accounting policy which must be adopted for tax purposes by the seller or purchaser in the context of a securitisation transaction.

**9.3 Stamp Duty, etc. Does Switzerland impose stamp duty or other documentary taxes on sales of receivables?**

No stamp duty is payable on sales of receivables unless such receivables are regarded as bonds, debentures or money market papers and are transferred by, or via, a securities dealer under Swiss stamp tax law. The statutory stamp duty rate amounts to 0.15 per cent on the transfer of Swiss bonds, debentures or money market papers, and to 0.3 per cent on bonds, debentures or money market papers issued by a non-Swiss person.

**9.4 Value Added Taxes. Does Switzerland impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

The sale of goods and the provision of services, including those of a collecting agent ("servicing"), are, in general, subject to Swiss value-added tax (VAT) at the current standard rate of 8.0 per cent.

The sale of receivables is exempt from VAT as a financial transaction but the purchaser may become liable for the VAT included in the assigned receivables.

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

In general, the taxing authority will not be able to make such claims regarding VAT, stamp duty or income and profit taxes.

However, on 1 January 2010, Switzerland introduced a completely revised VAT Act. The new act includes, under certain conditions, a secondary liability of the purchaser with respect to VAT included in receivables sold/assigned and remaining unpaid in the insolvency of the seller.

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Switzerland, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Switzerland?**

The mere purchase of receivables, appointment of the seller as its servicer or collecting agent, or the enforcement of receivables against the debtors does not make the purchaser subject to Swiss income tax under Swiss national income tax laws.

**Oliver Widmer**

Pestalozzi Attorneys at Law Ltd  
Loewenstrasse 1  
CH-8001 Zurich  
Switzerland

Tel: +41 44 217 9242  
Fax: +41 44 217 9217  
Email: [oliver.widmer@pestalozzilaw.com](mailto:oliver.widmer@pestalozzilaw.com)  
URL: [www.pestalozzilaw.com](http://www.pestalozzilaw.com)

Oliver Widmer is a partner and head of Pestalozzi's Private Client group and member of Pestalozzi's Financial Services group. He primarily advises domestic and international banks, financial institutions, wealth management service providers and high net worth individuals on banking, finance and capital markets matters. Further areas of work include domestic and cross-border trust, foundation and estate planning matters.

He is highly regarded by *The Legal 500* (Banking and Finance and Capital Markets), by *Chambers Global 2013* (Banking and Finance) and by *Chambers Europe 2013* (Banking and Finance), by *Citywealth Leaders List 2013* (International Lawyer), by Legal Media Group in its *Expert Guides 2013* (Trust and Estates) and in its *Best of Best Lawyers 2013* (Trust and Estates).

He graduated from the University of Zurich (*lic. iur.*, 1998) and the London School of Economics and Political Science (M.Sc., Law and Accounting, 2002). He was admitted to the Bar in Switzerland in 2000 and as a solicitor (not practising) of England and Wales in 2003, is an authorised issuer's representative at the SIX Swiss Exchange and is recognised as trust and estate practitioner (TEP) by STEP. Oliver Widmer joined Pestalozzi in 2001. In 2003/2004, he was seconded to head the Swiss law and compliance department of one major US investment bank.

**Urs Klöti**

Pestalozzi Attorneys at Law Ltd  
Loewenstrasse 1  
CH-8001 Zurich  
Switzerland

Tel: +41 44 217 9292  
Fax: +41 44 217 9217  
Email: [urs.kloeti@pestalozzilaw.com](mailto:urs.kloeti@pestalozzilaw.com)  
URL: [www.pestalozzilaw.com](http://www.pestalozzilaw.com)

Urs Klöti is Managing Partner of Pestalozzi and heads Pestalozzi's Financial Services group. His practice is focused on banking and capital markets, corporate finance, securities, insurance and corporate law.

Urs Klöti, born in 1965, graduated in economics from the University of St. Gall in 1990. In 1991/1992, he worked for a Swiss firm in Indonesia. In 1994, he graduated in law from the University of St. Gall and joined Pestalozzi in 1995. In 1998, he was admitted to the bar in Switzerland. From 2000 to 2003, Urs Klöti was Head of Law and Compliance of the Swiss institutional client bank in Zurich of one of the world's leading US investment banks. Urs Klöti's professional languages are German and English and he also speaks some Spanish.

PESTALOZZI



ATTORNEYS AT LAW

Pestalozzi's roots go back to 1911; of the major and most respected Swiss law firms, Pestalozzi has the longest tradition.

Supporting our international and domestic clients from our offices in Zurich and Geneva to reach their goals is our paramount ambition. With the extensive know-how, experience and the strong commitment of our staff of about 150 people, we help our clients achieve their goals quickly and efficiently. We are known for our integrity, our high quality, as well as for our efficacy.

For each project, we form a customised team to accommodate your specific needs. We have direct access to an international network of lawyers and can introduce you to an appropriate law firm in jurisdictions worldwide.

Three distinctive values guide us:

- We care for our clients: we provide them with result-oriented, effective and realisable solutions.
- We act responsibly: both competence and integrity are at the core of our services.
- We are committed to attracting and retaining dedicated and skilled people.

# Taiwan



David Chuang



Grace Ku

## LCS & Partners

### 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

(a) It is not necessary that the sales of goods or services are evidenced by a formal receivables contract. It is sufficient evidence of a transaction if there is either an oral or written agreement between the parties, except as otherwise required by law. For example, under the provisions of the Consumer Protection Act, a written agreement is required for instalment sales between enterprises and consumers.

(b) The court will decide whether invoices alone suffice to prove sales on a case-by-case basis. Generally, the court accepts invoices containing the essential legal elements of a contract.

(c) Under certain circumstances, the behaviour of the parties is sufficient for a receivable “contract” to be deemed to be existent. The court decides the matter on a case-by-case basis.

**1.2 Consumer Protections. Do Taiwanese laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

(a) Under the Taiwan Civil Law, if the rates of interest exceed twenty per cent (20%) *per annum*, the creditor shall not be entitled to claim any interest over twenty per cent (20%). In addition, in the case of a debt bearing interest, if no rate has been fixed by the contract or by the act, the rate shall be five per cent (5%) *per annum*.

(b) The creditor may claim interest on late payments in the event of default, to be calculated at the statutory rate. However, if the agreed rate of interest is higher, this higher rate shall apply.

(c) Normally, the consumers may not cancel receivables for a specified period of time, unless the law specifically permits so. For example, the Consumer Protection Act provides that, without stating reasons or paying any expenses or the purchase price, consumers of a mail order or door-to-door sale may cancel receivables within seven (7) days upon receipt of such goods by returning the goods or by notifying the business operators in writing to rescind the purchase contract.

(d) The right of pre-payment is provided for. If the agreed rate of interest is over twelve per cent (12%) *per annum*, after one year has elapsed, the consumers may, at any time, discharge the capital under the condition that the creditor has been notified one (1) month before the pre-payment. Most importantly, the right of discharge shall not be excluded or limited by the creditor.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

There are no different requirements and/or laws that apply to the sale or collection of those receivables where the receivables contract has been entered into with the government or a government agency.

### 2 Choice of Law - Receivables Contracts

**2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Taiwan that will determine the governing law of the contract?**

It depends on whether there is a foreign element involved. A “foreign element” means simply a contact with some system of law apparent, on its face, other than Taiwanese law. Such a contact may exist, for example, because a contract was made, or is to be performed, in a foreign country, or the receivables were transferred there, or because either party was not a Taiwanese national, or because neither of the parties are residents of Taiwan.

On one hand, if there is no foreign element involved, for example, under the conditions that both parties are incorporated in, or nationals of, Taiwan and the performance or the subject matter(s) involved is (are) within Taiwan, normally the court will determine that Taiwanese law governs.

On the other hand, where a foreign element is involved, the governing law of a contract is stipulated by the Act Governing the Application of Laws to Civil Matters Involving a Foreign Element, which provides that the law of the jurisdiction with the closest relevance to the contract shall be applied, unless it (i) violates the public order or *boni mores* of Taiwan, or (ii) evades a compulsory provision or a prohibition of Taiwanese law.

**2.2 Base Case.** If the seller and the obligor are both resident in Taiwan, and the transactions giving rise to the receivables and the payment of the receivables take place in Taiwan, and the seller and the obligor choose the law of Taiwan to govern the receivables contract, is there any reason why a court in Taiwan would not give effect to their choice of law?

Under such factual circumstances, it is unlikely that a court in Taiwan would not give effect to its choice of law. Normally, the court will determine Taiwanese law as the governing law under such conditions.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor.** If the seller is resident in Taiwan but the obligor is not, or if the obligor is resident in Taiwan but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Taiwan give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

In general, a court in Taiwan will give effect to the choice of foreign law made by both parties. However, pursuant to the provisions of the Act Governing the Application of Laws to Civil Matters Involving Foreign Elements, such choice of foreign law is limited in that such foreign law shall not (i) violate the public order or *boni mores* of Taiwan, or (ii) evade a compulsory provision or a prohibition of Taiwanese law.

**2.4 CISG.** Is the United Nations Convention on the International Sale of Goods in effect in Taiwan?

No, it is not in effect in Taiwan. Taiwan is not a party to United Nations Convention on the International Sale of Goods.

### 3 Choice of Law - Receivables Purchase Agreement

**3.1 Base Case.** Does Taiwanese law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Taiwanese laws or foreign laws)?

In Taiwan, the sale of receivables is not required to be governed by the same law as the law governing the receivables themselves. The seller and the purchaser are free to choose the governing law that shall apply to the sale of receivables. However, according to the Act Governing the Application of Laws to Civil Matters Involving Foreign Elements, the effect on the sale of receivables against the obligor shall be governed by the law governing the receivables. For example, under Taiwan law, except for the Financial Asset Securitization Act applied, a notice should be given to the obligor when there is a sale of receivables. Even if the governing law between the seller and the purchaser does not require them to do so, the Taiwan law governing receivables will prevail.

**3.2 Example 1:** If (a) the seller and the obligor are located in Taiwan, (b) the receivable is governed by the law of Taiwan, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Taiwan to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Taiwan, will a court in Taiwan recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Except for the Financial Asset Securitization Act applied, under such factual circumstances a court in Taiwan will generally recognise such sale as being effective against the seller, other third parties, and the obligor who has been notified. However, given that in this factual scenario the seller is located in Taiwan, the sales will remain subject to the Taiwanese laws and regulations with regard to bankruptcy, insolvency, and other related laws.

**3.3 Example 2:** Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Taiwan, will a court in Taiwan recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

According to the "Act Governing the Application of Laws to Civil Matters Involving Foreign Elements", a court in Taiwan will generally recognise such sale as being effective against the seller and other third parties. However, given that in this factual scenario, the seller is located in Taiwan, the sales will remain subject to the Taiwan laws and regulations with regard to bankruptcy, insolvency, and other related laws.

**3.4 Example 3:** If (a) the seller is located in Taiwan but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Taiwan recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Taiwan own sale requirements?

Assuming that the contract is valid and legally binding, based on the example provided in the question, a court in Taiwan will generally recognise such sale as being effective against the seller under the law of the obligor's country, unless it: (i) violates the public order or *boni mores* of Taiwan; or (ii) evades a compulsory provision or a prohibition of Taiwanese law. However, given that in this factual scenario the seller is located in Taiwan, the sales will remain subject to Taiwanese laws and regulations with regard to bankruptcy, insolvency, and other related laws.

**3.5 Example 4: If (a) the obligor is located in Taiwan but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Taiwan recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Taiwan own sale requirements?**

In general, as long as the contract is valid and legally binding, based on the facts provided, a court in Taiwan will recognise such sale as being effective against the seller under the law of the obligor's country. Nevertheless, such foreign law shall not be applied if it: (i) violates the public order or *boni mores* of Taiwan; or (ii) evades a compulsory provision or a prohibition of Taiwanese law.

**3.6 Example 5: If (a) the seller is located in Taiwan (irrespective of the obligor's location), (b) the receivable is governed by the law of Taiwan, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Taiwan recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Taiwan and any third party creditor or insolvency administrator of any such obligor)?**

Since the receivable is governed by the laws of Taiwan, whether both parties have chosen the governing law of the receivables contract or not, a court in Taiwan will generally recognise such sale as being effective against the seller under the law of the obligor's country, unless it: (i) violates the public order or *boni mores* of Taiwan; or (ii) evades a compulsory provision or a prohibition of Taiwan law. However, given that in this factual scenario, the seller is located in Taiwan, such sales will remain subject to the Taiwan laws and regulations with regard to bankruptcy, insolvency, and other related laws.

## 4 Asset Sales

**4.1 Sale Methods Generally. In Taiwan what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

First, a seller generally sells receivables to a purchaser using the customary method of executing the purchase agreement, that is, the seller sells and transfers the claim against the debtor to the purchaser and in exchange, the purchaser pays the agreed price upon consideration. Most importantly, under the Civil Law, except for the Financial Asset Securitization Act applied, the transfer of a claim will not be effective upon the obligor until the obligor has been notified of such claim by the transferor or transferee. However, there are three (3) kinds of claims that may not be transferred, each described in turn, where: (i) the nature of the claim restricts the transfer; or (ii) the parties have agreed that the claim shall not be transferred (although such agreement shall not be a valid defence against any *bona fide* third party); or (iii) the claim is not subject to judicial attachment.

Second, there is no particular terminology unanimously used to describe this condition in Taiwan. In general, terms such as "sale", "transfer" or "assignment" are all commonly accepted in transactions.

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

Generally, under Taiwan Civil Law, except for notifying the obligor of such a transfer, no formalities are required for perfecting a sale of receivables, and no additional formalities are required against subsequent good faith purchasers either. However, under the Financial Asset Securitization Act, instead of notifying the obligor, the transfer of assets shall make announcements of the variety, quantity, and content of the major assets entrusted to the trustee or transferred to the Special Purpose Company ("SPC") in accordance with the provisions of this act for three (3) consecutive days in the daily local newspapers circulated at the place of its principal office or in other ways prescribed by the Taiwan Financial Supervisory Commission.

**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

**(1) Promissory notes**

As mentioned in the preceding response to question 4.1 above, such sales require transfer to the purchaser. Under the Law of Negotiable Instruments, the additional requirements to transfer a promissory note issued by the obligor are: (i) endorsement on such promissory note by the seller to the purchaser; and (ii) delivery to the purchaser.

However, if the issuer makes an express statement on the promissory note that transferring by endorsement is prohibited, such promissory note is non-transferrable.

**(2) Mortgage loans**

A notice to the obligor is required when transferring a mortgage loan. Under Civil Law, there are two (2) types of mortgage loans: (i) a general mortgage; and (ii) a mortgage with a specified maximum amount to secure a creditor's unspecified claim. When the secured loan is transferred, a general mortgage will be transferred simultaneously to the purchaser, as such mortgage may not be transferred by separating it from the claim that it secures. On the contrary, with respect to a mortgage with a specified maximum amount to secure a creditor's unspecified claim, such mortgage will not be transferred along with the secured loan if the secured claim is transferred to another person prior to confirmation of the creditor's claim.

**(3) Consumer loans**

Under Civil Law, there are no additional or different requirements for the sale and perfection to apply to sales of consumer loans. The requirements are the same as those for receivables. However, if the seller is a final institution in Taiwan, the seller shall additionally comply with the regulations promulgated by the Financial Supervisory Commissions with regard to the sale of consumer loans.

**(4) Marketable debt securities**

The additional requirements vary with different types of securities. That is to say, there are different requirements for sales and

perfection of each type of marketable debt securities. Take corporate bonds, for example, they can be issued as registered or with bearer forms. On the one hand, the sale and purchase of the registered corporate bonds require endorsement and delivery. On the other hand, when a seller sells the corporate bonds with bearer form to the purchaser, the delivery alone will be sufficient to complete such sale. Moreover, either a registered corporate bond or one with a bearer form shall be made by book-entry only.

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

According to the Civil Law, if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment, the seller may transfer the receivables to the purchaser and notice to the obligor is required in order to be effective against the obligor, or (b) the receivables contract expressly prohibits assignment, the sales of receivables shall not be transferred. Most importantly, the benefit of giving notice to obligors is that even though the transfer may not be executed or is invalid, after the transferor (such as the seller) has notified the obligor of such transfer, the obligor may take all the defences which he has against the transferee (such as the purchaser) as valid defences against the transferor.

However, under the Financial Asset Securitization Act, transfer of assets shall only make announcements in the daily local newspapers circulated at the place of its principal office or in other ways prescribed by the Taiwan Financial Supervisory Commission, thus a notice to the obligor is not required.

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

First, there is no requirement regarding the form the notice must take or how it must be delivered. Moreover, there is no time limit beyond which notice is ineffective. The notice of sale may be delivered not only after the sale, but even after insolvency proceedings against the seller have commenced, under the condition that: (i) the sale occurs prior to the commencement of insolvency proceedings; or (ii) the bankruptcy administration does not rescind the sale. However, if the obligors repay the receivables to the seller before the seller or the purchaser provides notice to the obligors, such repayment will be effective even after the transaction.

Second, although there is no provision in the Civil Law stipulating for future receivables, based on judicial decisions by a Taiwan Court, such notice also applies to the transfer of future receivables. Nevertheless, once future receivables come into existence, the notice shall be delivered again to the obligor.

However, under the Financial Asset Securitization Act, the transfer of assets shall only be announced in the daily local newspapers circulated at the place of its principal office or in other ways prescribed by the Taiwan Financial Supervisory Commission, thus a notice to the obligor is not required.

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?**

First, such restriction shall not be interpreted as prohibiting a transfer of receivables by the seller to the purchaser. The restriction requires the consent of the obligor to transfer the rights and obligations, instead of banning the seller from transferring the receivables. If the seller transfers his rights and obligations without the obligor's consent, such transfer will take no effect against the obligor.

Second, the result is not the same if the restriction explicitly provides: "This Agreement may not be transferred or assigned by the seller without the consent of the obligor." This restriction requires the consent of the obligor to transfer the receivables, not rights or obligations.

**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Taiwan? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Taiwan recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

First, if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, such restrictions are generally enforceable in Taiwan.

Second, regarding contracts between commercial entities, there is no such exception.

Third, if the seller sells receivables to the purchaser without obeying the restrictions, the seller will be liable to the obligor for breach of contract. However, the obligor may claim damages and assert a defence against the seller that the sale is not effective upon the obligor.

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

There is no need for the sale document to specifically identify each of the receivables to be sold, the most reasonable and identifiable information such as the name of the obligor or the date of the contract would suffice. However, if the seller sells all of its receivables to the purchaser, or sells all of its receivables other than receivables owed by one or more specifically identified obligors to the purchaser but provides no other information to the seller, it may not be sufficient to identify the receivables.

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

First, a Taiwanese court will not automatically treat the parties' denomination of their transaction as a sale, but will take the economic characteristics of the transaction into account. That is to say, the court will examine the intent of both parties, the economic effect, and the characteristics of the transaction to determine whether it is a sale, a loan or otherwise.

Second, except for the Financial Asset Securitization Act applied, if the receivable is legally transferred to the purchaser, the purchaser pays a fair consideration, the seller does not have any intent to damage its own creditor, and the obligor has been duly notified, such transfer will be regarded as a valid sale under the Civil Law. Therefore, based on the requirements for a sale, if the seller only notifies the obligor without actually transferring the claim to the purchaser, such act, or failure to act, might prevent the perfection of sale.

Third, in connection with any such assignment, the mere retention by the seller of the risk that the receivables exist and are legal, valid, binding, and enforceable does not result in jeopardising the character of the sales transaction, and neither does the continued servicing of the receivables by the seller.

(a) With regard to the credit risk, and in particular, on the seller retaining an excessive portion of the credit risk from the receivables sold, the seller may retain some portion of the credit risk combined with historical default rates, taking enforcement costs into account.

(b) Concerning the interest rate risk, since interest payment is normally not one of the deemed characteristics of a sale, if interest rate risk is arranged in a sale, the Taiwan Court would likely make inquiries as to the nature of such transaction. However, interest rate risks exist in certain type of sales, such as those where late payment of the purchase price or delay of delivering the goods are involved.

(c) As for the control of collection of receivables, generally the purchaser may delegate the collection of receivables to the seller after the seller sells and transfers the receivables to the purchaser. Hence, it does not result in jeopardising the true character of the sales transaction.

(d) Lastly, under the Civil Law as the requirements for a sale, mentioned in the preceding paragraph, have all been satisfied, the transaction will be regarded as a sale and will not be affected by the right of repurchase or redemption.

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

Yes, the seller may agree, in an enforceable manner, to continuous sales of receivables since it is not prohibited under Taiwanese laws.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?**

First, according to the judicial judgments declared by a Taiwan Court, the Court generally recognises the sales of future receivables so long as the receivables are sufficiently specified and identified. Hence, the seller may commit, in an enforceable manner, to sell receivables to the purchaser that come into existence after the date that the receivables purchase agreement is executed.

Second, Taiwanese law does not require any specific sales structure for the sale of future receivables to be valid and enforceable, beyond the requirements applicable to receivables sales generally.

Third, there is a distinction between future receivables that arise prior to, and after, the seller's insolvency. If the seller has been declared insolvent by the Court, the receivables that arise after the insolvency will become a part of the bankrupt estate as stated in the response to question 6.5 below.

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

Under the Civil Law, related securities consisting of receivables are transferred by way of assignment, requiring an agreement between the seller and the purchaser to assign the relevant securities. However, there are few exceptions with regard to the transfer of secured receivables, as additional formalities must be fulfilled based on different types of security interest involved. For instance, if the security interest is a pledge over personal property, the possession of the pledged personal property shall be delivered to the purchaser to foreclose the property. Moreover, as specified in the response to question 4.3 above, if it involves the sale of a mortgage with a specified maximum amount, in order to foreclose the mortgage, the purchaser shall register as the new mortgagee with the local land administration authorities.

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

According to the Civil Law, at the time the obligor is notified, if the obligor had the right of claim against the seller and if such claim expired prior to, or simultaneously with, the transfer of the claim, the obligor may still claim its set-off right against the purchaser. Therefore, the obligor's set-off rights will not be terminated upon its receipt of notice of a sale.

However, if a receivables contract does not waive the set-off, but the obligor's set-off rights are terminated due to defect in notice or some other action, whether or not the obligor may claim damages against either the seller or the purchaser depends on whether the obligor has claimed his set-off right. If the obligor has claimed its set-off right before being notified, the obligor will be free from the obligation of the amount that has been set-off. Thus, even if the sale of the receivable is before the obligor claimed its set-off right, as long as the obligor exercises its set-off right against the seller and is not notified of the sale, the purchaser will not be able to collect the amount that has been set-off from the obligor. If not, the obligor may not sue either or both the seller and/or purchaser for liability.

Nevertheless, under the Financial Asset Securitization Act, the transfer of assets shall only be announced in the daily local newspapers circulated at the place of its principal office or in other ways prescribed by the Taiwan Financial Supervisory Commission, thus a notice to the obligor is not required.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Taiwan to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

It is not customary in Taiwan to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security in the event that the court deems the sale unperfected. Nevertheless, an alternative method often used by the purchaser is the purchaser requesting the seller to issue a promissory note in the event that the sale is deemed invalid by the Court and the purchaser is not reimbursed by the seller.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Taiwan, and for such security interest to be perfected?**

Please refer to the response to question 5.1 above.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Taiwan to grant and perfect a security interest in purchased receivables governed by the laws of Taiwan and the related security?**

For granting a security interest in receivables, a "pledge of rights"

is usually used to purchase securities in Taiwan. According to the Civil Law, if the subject of a pledge is a claim, for example, a receivable, the pledge shall be created in writing. Further, if there is any document evidencing a receivable, the pledger is obligated to deliver it. In addition, the transfer of a receivable will not be effective against the obligor until the obligor has been notified of it by the pledger or pledgee, unless otherwise provided by the relevant act. However, the regulations mentioned above will only affect the exercise of the pledge rather than avoid the perfection of the pledge. There is no need to record the pledge of receivables with competent authorities.

On the other hand, with regard to the foreign legal entities, if the foreign country has no treaty with Taiwan, such legal entities shall be recognised pursuant to the Taiwan Company Act to have a security interest.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Taiwan, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Taiwan or must additional steps be taken in Taiwan?**

According to the Act Governing the Application of Laws to Civil Matters Involving Foreign Elements, the pledge of rights is governed by the law of the jurisdiction where the right is formed. If the receivables are governed by Taiwan law, the formation and perfection of the pledge of rights over receivables have to be regulated by Taiwan law as well. If the pledger and pledgee choose not to use Taiwan law as their governing law concerning the pledge, the formation and perfection of the pledge shall be governed by Taiwan law as described in the response to question 5.3 above. In the event that the formation and perfection of the pledge is governed by a law other than Taiwan law and not connected with Taiwan law, such pledge will not be accepted by the Taiwan Court.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

**1. Insurance policies**

According to the Insurance Law, pledge of rights under a life insurance contract entered into by a third party shall not be effective without the written acknowledgment of the insured.

**2. Promissory notes**

Generally, it is not customary to form a pledge via a promissory note in Taiwan and there is no regulation regarding the method to form a pledge via a promissory note based on the Negotiable Instruments Law, however, there have been arguments about pledging the promissory note by following the general regulations of a pledge over securities stipulated in the Civil Law.

**3. Mortgage loans**

There are no additional or different requirements that apply to security interests for mortgages loans in Taiwan.

**4. Consumer loans**

There are no additional or different requirements that apply to security interests for consumer loans in Taiwan.

**5. Marketable debt securities**

To form and exercise a pledge of marketable debt securities, the general rules regarding pledge of securities apply. That is, the creation of the pledge of marketable debt securities becomes



effective by the delivery of such securities to the pledgee and/or endorsement made by the pledgor.

**5.6 Trusts. Does Taiwan recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Yes, trusts are recognised in Taiwan.

**5.7 Bank Accounts. Does Taiwan recognise escrow accounts? Can security be taken over a bank account located in Taiwan? If so, what is the typical method? Would courts in Taiwan recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Taiwan?**

Although an “escrow account” is not the legal terminology used under Taiwanese law, the pledges over a bank account are accepted. As described in the response to question 5.3 above, the pledges over a bank account shall be created in writing and the bank shall be notified. Nonetheless, a “floating charge” is not a legal concept under Taiwanese law. In fact, with regard to the pledges over a bank account, the pledger shall deliver the credit balance statements of its bank accounts each month on which a pledge is formed to the pledgee, and the receivables under the accounts shown by the number in the aforementioned statement would be the subject receivables of pledge. The Taiwan Court will recognise a foreign law grant of security taken over a bank account located in Taiwan if the formation and perfection of such security is consistent with Taiwan law.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

Generally, all cash flowing into the bank account from enforcement onward will not be controlled by the secured party, apart from the approval from the pledger and the notification to the bank of the pledge.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Under Taiwanese law, even though the deposit has been pledged, the owner is allowed to have access to the funds in the bank account. However, each bank might have its own rules stated in the pledge agreement. For instance, it is stated in some pledge agreements that with regard to a time deposit, the owner shall not have access to the funds in the bank account unless he/she provides the written notice concerning the extinguishment of pledge.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Taiwan's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

(1) Whether the purchaser may collect, transfer or otherwise exercise ownership rights over the purchased receivables depends on the transfer and existence of the receivables. In other words, if the receivables have been transferred validly to the purchaser and exist before the seller becomes subject to an insolvency proceeding, the purchaser is allowed to engage in the aforementioned actions. However, if the receivables come into existence after the seller becomes subject to an insolvency proceeding, the future receivables will be recognised as a part of the bankruptcy estate, which means the purchaser is not allowed to engage in the aforementioned actions.

(2) Under the Bankruptcy Law, the insolvency official has no ability to stay collection and enforcement actions unless he applies to the Court for the revocation of the transaction. In other words, if the action or the transaction was conducted by the seller, with or without consideration, before the seller became subject to an insolvency proceeding, regarded as the detriment to the right of the seller's creditor, the insolvency official shall file an action in the Court for the revocation of the action or the transaction. That means once the transfer of receivables is rescinded by the Court, the purchaser will not be able to engage in the aforementioned actions. The answer will be the same if the purchaser is deemed to only be a secured party rather than the owner of the receivables.

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

Please refer to the response to question 6.1 above.

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Taiwan for (a) transactions between unrelated parties, and (b) transactions between related parties?**

According to the Bankruptcy Law, the insolvency official has the right to rescind the following legal actions taken by the insolvent within six (6) months before the declaration of bankruptcy (“Suspect Period”):

- (1) Providing collateral to outstanding debt, aside from such legal actions committed prior to the beginning of the Suspect Period.
- (2) Performing an undue obligation.

The Suspect Period is the same, whether transactions happened between unrelated or related parties.

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

Under Taiwan law, except for the circumstances specified in the response of question 6.3, once the purchaser and the seller are individual legal entities, the insolvency official is unable to consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding.

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Taiwan, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

As described in the response to question 6.1 above, once the seller becomes subject to an insolvency proceeding, the future receivables of the seller will be recognised as a part of the bankruptcy estate, which means the purchaser is not allowed to collect, transfer or otherwise exercise rights over such receivables.

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

Under the Bankruptcy Law, the debtor will be declared insolvent when he is unable to pay the debts. The Court will approve the debtor's bankruptcy declaration only when it meets the requirement of being unable to repay the debt in the long term. Generally, the standard insolvency declaration will not be affected by a limited recourse provision established in a debtor's contract if there is a limited recourse provision. However, if the amount required in the limited recourse provision is affordable to the debtor, even if the debtor cannot pay the whole amount of the debt, the Court may not necessarily rule the debtor is an insolvent debtor and approve the bankruptcy declaration if no other debts will affect its solvency.

## 7 Special Rules

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Taiwan establishing a legal framework for securitisation transactions? If so, what are the basics?**

Yes, in order to improve the liquidity of financial assets and real estate through securitisation and protect investments, there are two essential regulations regarding securitisation: (1) the Financial Asset Securitisation Act; and (2) Clauses of the Real Estate Securitisation Act.

**(1) The Financial Asset Securitisation Act**

According to the Financial Asset Securitisation Act, there are two different methods for a financial institution or an institution (“the

originator”) approved by the competent authority to securitise its financial assets:

**I. Special Purpose Trust (“SPT”):**

The SPT refers to the trust relationship established for the purpose of asset securitisation. In other words, after organising the asset pool, the originator entrusts the assets to a trustee. Upon the approval of the competent authority or an effective registration, the SPT will be established and the trustee will raise funds by issuing beneficiary certificates through public offerings or private placements. The investors who participate in the private placements shall be specified. Furthermore, the originator and the trustee shall not be the same affiliated enterprise.

**II. Special Purpose Company (“SPC”):**

A SPC shall be established by financial institutions and refers to a company-limited-by-share with only one shareholder incorporated under the approval of the competent authority for the purpose of engaging in the business of asset securitisation by issuing asset-backed securities. Furthermore, the aforementioned financial institutions and the trustee shall not be the same affiliated enterprise and such financial institutions may be appointed by the SPC as the servicer to collect the rights from the debtor.

**(2) Clauses of the Real Estate Securitisation Act**

According to Clauses of the Real Estate Securitisation Act, there are two different methods for real estate securitisation established only by trust:

**I. Real estate investment trust (“REIT”):**

A REIT means a trust established to invest in real estate, related rights of real estate, real estate-related securities, as well as other investment objects approved by the competent authority, whereby the beneficiary certificates of REIT are issued to non-specific persons through public offerings or delivered to specific persons through private placements.

**II. Real estate asset trust (“REAT”):**

REAT means a trust established, by which thrusters transfer their real estate or relevant rights to a trustee to issue REAT beneficiary certificates to non-specific persons through public offerings or deliver REAT beneficiary securities to specific persons through private placements, evidencing the beneficiaries' rights to the real estate of such trust, relevant rights, or profits, interests, and other proceeds accrued therefrom.

**7.2 Securitisation Entities. Does Taiwan have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

In addition to the response to question 7.1 above, there are further requirements regarding the securitisation of entities under the Financial Asset Securitisation Act and Clauses of the Real Estate Securitisation Act as follows:

**(a) Requirements for the establishment and management of such an entity**

Concerning the requirements for the establishment of special-purpose entities, please refer to the response to question 7.1 above. Regarding the management of such entities, the Financial Asset Securitisation Act and Clauses of the Real Estate Securitisation Act stipulate that:

## I. Financial Asset Securitisation

## (1) SPT

Generally, the SPT can be managed by itself or the management may be delegated to an institution (servicer) to manage and dispose of the trust property or transferred assets which shall be stated expressly in the asset trust securitisation plan.

## (2) SPC

The SPC shall delegate an institution (servicer) to manage and dispose of the transferred assets. For the protection of transferred assets, the institution shall separately manage such assets and its own property. Creditors of the servicer shall have no claims or other rights against such assets and/or property.

## II. Real Estate Securitisation

The special-purpose entity in real estate securitisation may be managed by itself or the management may be delegated to a professional real estate management institution, i.e. a real estate investment enterprise, construction enterprise, construction management enterprise, real estate purchase/sale and leasing enterprise, or other institutions approved by the competent authority.

**(b) Legal attributes and benefits of the entity**

Based on the descriptions in the response to question 7.1 above, the creation of the entity may be used to achieve the purposes of bankruptcy, remoteness, and off-balance.

**(c) Specific requirements as to the status of directors or shareholders**

The SPC shall have at least one (1) director and no more than three (3) directors. The directors have a fiduciary duty with respect to the SPC and shall perform their duties with due diligence. The directors of the SPC shall represent the SPC externally. When there are several directors, one of them shall be designated, in the Articles of Incorporation, to represent the company externally. In addition, the shareholders shall not transfer their shares to other persons without the approval of the competent authority. Furthermore, the shareholders may request in writing for the supervisor of the company to institute an action against a director on behalf of the SPC.

**7.3 Limited-Recourse Clause. Will a court in Taiwan give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

Basically, a court in Taiwan will give effect to such a provision. However, the restrictions on the choice of governing law as noted in the response to question 2.1 above need to be considered as well. That is, it will depend on whether there is a foreign element involved in such provision or not.

**7.4 Non-Petition Clause. Will a court in Taiwan give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

A court in Taiwan will give effect to such a provision. Please refer to the responses to questions 7.3 and 2.1 above.

**7.5 Priority of Payments "Waterfall". Will a court in Taiwan give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

A court in Taiwan will give effect to such a provision. Please refer to the responses to questions 7.3 and 2.1 above.

**7.6 Independent Director. Will a court in Taiwan give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

Unless otherwise provided by law, a court in Taiwan will give effect to such a provision.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Taiwan, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Taiwan? Does the answer to the preceding question change if the purchaser does business with other sellers in Taiwan?**

According to the Taiwan Company Act, a foreign company may not transact or conduct business within the territory of Taiwan without obtaining a certificate of recognition from the government of Taiwan and completing the procedure(s) for branch office registration. The definition of "transact or conduct business" will be decided by the court on a case-by-case basis, rather than specifically stipulating for such definition in the Company Act. Generally, if a foreign purchaser engages in enforcing purchases, collections, or receivables once in a while and such activities are not included in its scope of business, it might not be considered as transacting or conducting business in Taiwan. The answer will be the same regardless of whether the purchaser conducts business with other sellers in Taiwan.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

Generally, the answer is "no" to the both questions. However, as stated in the response to question 8.1 above, there is no specific definition of "conducting business" under Taiwanese law. Once the enforcement and/or collection of receivables by a seller or a third party replacement servicer are considered as "conducting business" in Taiwan, the requirements under the Company Act for a foreign company shall be applied.

**8.3 Data Protection. Does Taiwan have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

Yes, the use or dissemination of data about, or provided by, obligors will be regulated by the Personal Information Protection Act (“PIP” Act) and the Trade Secrets Act (“TS” Act) in Taiwan. The definition of “personal information” under the PIP Act includes personal data, which may be used to identify a natural person only. For enterprises, the use or dissemination of data might be protected if it meets the definition of “trade secret” under the “TS” Act, which means any method, technique, process, formula, programme, design, or other information that may be used in the course of production, sales, or operations, and also meets the following requirements: (1) it is not known to persons generally involved with such type(s) of the information; (2) it has economic value, actual or potential, due to its secretive nature; and (3) its owner has taken reasonable measures to maintain its secrecy.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Taiwan? Briefly, what is required?**

Concerning the purchase of consumer loans, please refer to the response to question 4.3 above. In addition, as we mentioned in the response to question 1.2 above, regarding consumers of a mail order or door-to-door sale, the Consumer Protection Act provides that without stating reasons or paying any expenses or the purchase price, consumers of a mail order or door-to-door sale may cancel receivables within seven (7) days upon receipt of such goods by returning the goods or by notifying the business operators in writing to rescind the purchase contract.

**8.5 Currency Restrictions. Does Taiwan have laws restricting the exchange of Taiwanese currency for other currencies or the making of payments in Taiwanese currency to persons outside the country?**

Yes, regarding the management of foreign exchange, there is the Foreign Exchange Control Act and other regulations stipulated by the Central Bank of the Republic of China (Taiwan) (the “CBC”). Under the “Regulations Governing the Declaration of Foreign Exchange Receipts and Disbursements or Transactions” stipulated by the CBC, the amount of total annual remittance depends on the subject:

1. Individual

Total annual remittance not exceeding USD 5 million by a natural person may proceed directly through authorised banks. Total remittance exceeding the said amounts requires the CBC’s prior approval.

For a single remittance by an individual with an amount over USD 500,000, it may not be processed until the banking enterprise has confirmed that the Declaration Statement is consistent with relevant contracts and letters of approval that evidence the foreign exchange receipts and disbursements or transactions in question.

2. Company

Total annual remittance not exceeding USD 50 million by a person entity may proceed directly through authorised banks. Total remittance exceeding the said amounts requires the CBC’s prior approval.

For a single remittance by a company with an amount over USD 1 million, it may not be processed until the banking

enterprise has confirmed that the Declaration Statement is consistent with relevant contracts and letters of approval that evidence the foreign exchange receipts and disbursements or transactions in question.

## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Taiwan? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

Whether the payment on receivables by the obligors to the seller will be subject to withholding tax depends on the nature of the receivables. Generally, under the Income Tax Act, the payment will not be subjected to withholding tax. However, when the obligor is a business entity, if there is any interest incurred on the payment on receivables, such interest will be subject to withholding tax. The term of maturity of the receivables and the place that the seller or the purchaser is located are irrelevant to the obligation of withholding. There will be a risk that the deferred purchase price will be recharacterised, in whole or in part, as interest depending the provision of the agreement.

**9.2 Seller Tax Accounting. Does Taiwan require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

The business entity in Taiwan should follow the R.O.C. GAAP. There is no statute that specifically provides for an accounting policy for the seller or the purchaser in the context of a securitisation transaction, so the R.O.C. GAAP will generally control.

**9.3 Stamp Duty, etc. Does Taiwan impose stamp duty or other documentary taxes on sales of receivables?**

The stamp tax will be imposed if the contract is executed within Taiwan. The sale of receivables will be classified as an agreement for the sale of movable property. Thus, the sales of receivables will be subject to a stamp duty of NT\$ 12. However, under the Financial Asset Securitization Act, the stamp duty will be exempted if the receivables transfer is made in line with a trust plan approved by the competent authority.

**9.4 Value Added Taxes. Does Taiwan impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

Yes, under the Value-added and Non-value-added Business Tax Act, the sale of goods or services will be subject to value added tax. Generally, the sale of receivables is deemed as a sale of service. Hence, when the purchaser gains profits from the transaction, the purchaser will be subjected to value added tax for such profits.

Rendering collection agent services might also be considered sale of services and the fee for rendering services will be subject to value added tax as well.

**9.5 Purchaser Liability.** If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

If the seller is required to pay value added tax or stamp duty upon the sale of receivables, and the law stipulates that the seller is the taxpayer rather than the purchaser, the tax authority will not be able to make claims for the unpaid tax against the purchaser or the sold receivables thereof.

**9.6 Doing Business.** Assuming that the purchaser conducts no other business in Taiwan, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Taiwan?

The purchaser will be subject to income tax on the profit(s) of the transaction within Taiwan even if the purchaser conducts no other business in Taiwan. If the seller appoints itself as its servicer and collection agent, the seller may be considered the business agent of the purchaser in Taiwan and the purchaser may be subject to tax in Taiwan.

### Acknowledgment

The authors would like to thank Khloe Lai (Email: khloelai@lcs.com.tw) for her invaluable assistance in the preparation of this chapter.



**David Chuang**

LCS & Partners  
5F, No. 8, Sec 5., Xinyi Road  
Xinyi District, Taipei City  
Taiwan

Tel: +886 2 2729 8000  
Fax: +886 2 2722 6677  
Email: davidchuang@lcs.com.tw  
URL: www.lcs.com.tw

Admitted in Taiwan.

**Education:**

Duke University, School of Law (LL.M.).

**Areas of Expertise:**

Securitisation, Real Estate, Banking, Structured Finance, M&A.

**Publications:**

- Business Law Commentary by LCS Elites (January 2012).
- Legal Guide for A + Companies (January 2010).



**Grace Ku**

LCS & Partners  
5F, No. 8, Sec 5., Xinyi Road  
Xinyi District, Taipei City  
Taiwan

Tel: +886 2 2729 8000  
Fax: +886 2 2722 6677  
Email: graceku@lcs.com.tw  
URL: www.lcs.com.tw

Admitted in Taiwan.

**Education:**

National Taiwan University (LL.M.).

**Areas of Expertise:**

Securitisation, Investment Trust and Consulting Regulations, Trust, Securities Compliance and Litigation.

**Publications:**

- Business Law Commentary by LCS Elites (January 2012).
- Legal Guide for A + Companies (January 2010).



**LCS & Partners** ("LCS") is an elite corporate law firm based in Taipei. Since the firm was founded in 1998, it has grown rapidly to approximately 50 legal professionals and gained a reputation as one of the top corporate law firms in Taiwan that regularly handles major and complex cases for top-tier domestic and international clients. As a testament of LCS' success, LCS has consistently been ranked among the top M&A firms by Bloomberg and others since 2000.

LCS distinguishes itself from other traditional Taiwan law firms in its ability to handle complex international legal matters. Most of LCS' members received LL.M., J.D. and/or S.J.D. degrees from law schools in the United States. LCS is a member of the World Services Group. The World Services Group is a global membership association of law firms and other professionals. There are more than 130 member firms in more than 115 countries and throughout the United States.

# Trinidad & Tobago

J.D. Sellier + Co.

William David Clarke



Donna-Marie Johnson



## 1 Receivables Contracts

- 1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

### Sale of Goods

(a) Section 6 of the Sale of Goods Act, Chap. 82:30 provides that the sale of any goods of the value of TT\$100 or upwards shall not be enforceable by action unless the buyer accepts part of the goods so sold, and actually receives the same, or gives something in earnest to bind the contract, or in part payment, or unless some note or memorandum in writing of the contract is made and signed by the party to be charged or his agent in that behalf.

(b) The issue of an invoice by the seller is sufficient evidence of the contract, provided that the buyer has accepted at least part of the goods and actually receives them. Acceptance takes place: (a) if the buyer examines the goods or takes a sample in order to confirm that they are in accordance with the contract; (b) if he marks the goods as goods to be delivered under a contract for sale; (c) if he resells or attempts to resell the goods or does some other act in relation to them which amounts to acceptance; or (d) the goods being at the time of contract in the possession of the buyer as the seller’s bailee, the buyer acts in relation to them in a manner inconsistent with his former possession as bailee. Otherwise, there must be a written contract or memorandum signed by the buyer. A typical example of a written memorandum would be a purchase order signed by the buyer which is unconditionally accepted by the seller.

### Contract for Services

It is not necessary that a contract for services be evidenced in writing. It may be made orally or in writing, or partly orally and partly in writing, or it may be implied from the conduct of the parties. The issue of an invoice by the seller is sufficient evidence of the contract.

- 1.2 Consumer Protections. Do Trinidad and Tobago laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

(a) Section 12 of the Money Lenders Act, Chap. 84:04 provides that

no person other than a money lender licensed under the act shall charge interest on loans in excess of 24 per cent simple interest *per annum*. In practice, this limit is also applied to consumer credit and other receivables transactions.

A money lender does not include any person *bona fide* carrying on the business of banking or insurance or *bona fide* carrying on any business not having for its primary object the lending of money, in the course of which, and for the purpose of which, he lends money.

(b) There is no statutory right to interest on late payments prior to judgment. Interest on late payment would normally be a contractual term agreed between the parties. In the absence of a specific contract, the court will usually award interest on a commercial loan at normal overdraft rates up to judgment. Judgment creditors under a money judgment are entitled to interest at the statutory rate of 12 per cent *per annum* from the date of judgment to the date of payment.

(c) There is no law which permits the cancellation of receivables for a specified period of time. It is to be noted, however, that pursuant to the Bankruptcy Act Chap. 9:70 (“the Bankruptcy Act”), a debtor commits an act of bankruptcy if he gives notice to any of his creditors that he has suspended, or that he is about to suspend, payment of his debts.

(d) The Unfair Contract Terms Act, Chap. 82:37 provides certain rights to consumers with respect to debts owed by them; for example, certain liabilities for negligence of the seller/lender cannot be excluded under the terms of the contract.

- 1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

Contracts by the State or Government entities requiring payment of money are normally subject to the consent of the Minister of Finance and/or the Minister having responsibility for the entity. There are also special provisions in statutes governing certain types of loan or financing transactions or specific Government entities as well as municipal and regional corporations. Under the State Liability and Proceedings Act, Chap. 8:02, there are restrictions on the remedies which may be granted in proceedings against the State and procedures for the enforcement of such remedies.

## 2 Choice of Law - Receivables Contracts

- 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Trinidad and Tobago that will determine the governing law of the contract?**

If there is no express choice of law in a contract, the court will consider whether it can ascertain that there was an inferred or implied choice of law by the parties, or failing that, the court will determine the applicable law by judicial determination of the system of law with which the transaction has the closest and most real connection. For example, if the parties agree that arbitration shall take place in a particular country or that the courts of a particular country will have jurisdiction over the contract, that is a strong inference that the parties have impliedly chosen the law of that country as the proper law. Where no such choice can be inferred, the court will hold the contract to be governed by the law of the country with which the transaction is most closely connected.

- 2.2 Base Case. If the seller and the obligor are both resident in Trinidad and Tobago, and the transactions giving rise to the receivables and the payment of the receivables take place in Trinidad and Tobago, and the seller and the obligor choose the law of Trinidad and Tobago to govern the receivables contract, is there any reason why a court in Trinidad and Tobago would not give effect to their choice of law?**

No, there is not.

- 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Trinidad and Tobago but the obligor is not, or if the obligor is resident in Trinidad and Tobago but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Trinidad and Tobago give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

Where the parties expressly stipulate that a contract is to be governed by a particular law, that law will be the proper law of the contract. This freedom of choice is subject to some limitations. The selection of a foreign law must be *bona fide* and legal (at least under Trinidad and Tobago law if a Trinidad court is required to adjudicate on this issue) and there must be no reason for avoiding the choice on the grounds of public policy. Express selection of a foreign law will not prevent the application of mandatory provisions of any local law which would normally have been applicable to the transaction but for the parties' choice of foreign law.

- 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Trinidad and Tobago?**

No, it is not.

## 3 Choice of Law - Receivables Purchase Agreement

- 3.1 Base Case. Does Trinidad and Tobago law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Trinidad and Tobago's laws or foreign laws)?**

No, it does not.

- 3.2 Example 1: If (a) the seller and the obligor are located in Trinidad and Tobago, (b) the receivable is governed by the law of Trinidad and Tobago, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Trinidad and Tobago to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Trinidad and Tobago, will a court in Trinidad and Tobago recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?**

Yes. A court in Trinidad and Tobago will recognise the sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor). An exception is where on insolvency of the seller, a court may deem the sale to be a fraudulent preference of the buyer in the case where the consideration for the sale consisted of, or included, settlement of a debt owed by the buyer to the seller. See a further explanation in our answers to questions 6.1, 6.2 and 6.3 below.

- 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Trinidad and Tobago, will a court in Trinidad and Tobago recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?**

Subject to the exception noted in our answer to question 3.2, the courts in Trinidad and Tobago will recognise the sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, without taking into account the foreign law requirements of the obligor's country or the purchaser's country (or both).

- 3.4 Example 3: If (a) the seller is located in Trinidad and Tobago but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in Trinidad and Tobago recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Trinidad and Tobago own sale requirements?**

Subject to the exception noted in our answer to question 3.2, the

courts in Trinidad and Tobago will recognise the sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), without the need to comply with Trinidad and Tobago's own requirements.

**3.5 Example 4: If (a) the obligor is located in Trinidad and Tobago but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in Trinidad and Tobago recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Trinidad and Tobago own sale requirements?**

Yes, it will.

**3.6 Example 5: If (a) the seller is located in Trinidad and Tobago (irrespective of the obligor's location), (b) the receivable is governed by the law of Trinidad and Tobago, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in Trinidad and Tobago recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Trinidad and Tobago and any third party creditor or insolvency administrator of any such obligor)?**

Yes, it will, subject to the exception noted in our answer to question 3.2.

## 4 Asset Sales

**4.1 Sale Methods Generally. In Trinidad and Tobago what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?**

The sale of receivables is generally effected by way of a Factoring Agreement or an Assignment Agreement so as to vest in the assignee the legal right to the debt and all the remedies therefor with power to give a good discharge without the concurrence of the seller.

**4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

(i) Notice is necessary to make the obligor liable to the assignee. Accordingly, notice of the assignment must be given to the obligor by the purchaser.

(ii) Stamp duty is chargeable and payable in respect of the sale of the receivables (see our response to question 9.3 below for details).

**4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

### Promissory Notes

A promissory note is a negotiable instrument and is transferable by the endorsement of the note.

### Mortgage Loans

Normally the sale would be effected by a Deed of Assignment whereby the debt and the real property securing the same are transferred to the purchaser. Stamp duty is chargeable and payable on the deed at the rate of 0.05 per cent of the consideration. The Deed of Assignment must be registered in the Deeds Registry.

### Consumer Loans

Same as the response to question 4.2.

### Marketable Debt Securities

The sale would be effected by the seller and purchaser executing a standard form transfer and seller delivering the certificate to the purchaser. Upon delivery of these documents to the Registrar or Trustee, a new certificate is issued in the name of the purchaser and his name will be recorded as holder of the security.

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?**

Yes. With respect to both a legal and equitable assignment, in order to make the assignee's title effective against the obligor, notice of the assignment must be given to the obligor though no assent or acquiescence on the part of the obligor is necessary. The assignee takes subject to all equities existing between the assignor and the obligor up to the date of giving notice of the assignment.

(a) The answer to the question does not vary if the receivables contract does not prohibit assignment but does not expressly permit assignment.

(b) If the receivables contract expressly prohibits assignment by the party entitled to the benefit thereof, then an assignment thereof without the obligor's consent is ineffective to vest the contractual rights in the assignee even after notice of the assignment is given to the obligor. The obligor remains liable to the assignor and obtains a good discharge by payment to him. Further, the assignee takes subject to all equities between the assignor and the obligor arising at any time, e.g., a right of set-off arising after notice of assignment is given. Accordingly, the consent of the obligor must be obtained for assignment of the contractual rights. However, unless by the terms of the contract the restriction clearly extends to the debt arising from performance of the contract, the debt is assignable without the obligor's consent and is enforceable by the assignee once notice has been given to the obligor.

The giving of notice of the assignment to the obligor cuts off obligor set-off rights and other obligor defences arising after the



date of notice. An assignee of a chose in action takes subject to all rights of set-off and other defences which were available against the assignor, subject to this exception, that after notice of the assignment is given the debtor by payment or otherwise cannot do anything to take away or diminish the rights of the assignee as they stood at the time of the notice.

The giving of notice to the obligor also gives priority to the assignee against any competing interests for the same debt. Notice also:

- (i) fixes the rights of the parties in relation to the debtor's countervailing rights;
- (ii) prevents the discharge of the debtor by subsequent payment to the client/seller;
- (iii) avoids changes in terms in the contract of sale (which have not been authorised by the factor/assignee) being enforceable against the factor; and
- (iv) enables the factor to take proceedings for recovery of the debt in his own name.

---

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

---

Apart from the need for a "written" notice in the case of a statutory assignment, the notice may take any form. All that is required is that the debtor should be given to understand that the debt has been made over by the creditor to some third party. However the "notice" must clearly indicate that this has occurred and therefore ambiguous notices will not qualify as "notices". Generally, notice must be given at the time of, or after, the assignment/sale has occurred.

A notice may be delivered after insolvency proceedings are commenced against the seller where the agreement between the seller and factor is of a whole turnover type and is made prior to the commencement of the proceedings, subject to the exception set out in our answer to question 3.2. In such an agreement the ownership of the debts vests in the factor from the date of the agreement. These debts will include not only those debts notified to him but all those specified in the agreement and earned by the performance of the relevant contract of sale or service by the company. In respect of any such invoiced debts not notified to him, the factor may exercise all rights of ownership, including the giving of notice to debtors and collection.

With a facultative type of agreement the factor has no rights of ownership at all to any debts not offered to him even if they are earned by performance of the contract of sale or service before the commencement of the insolvency proceedings. Accordingly, he has no right to give notice to the obligor in respect of debts which have not been offered to him and accepted prior to the insolvency proceedings. Any notice given to the debtor after the commencement of insolvency proceedings against it is ineffective. As from the date of the commencement of the insolvency proceedings the company must cease to carry on its business except for the purpose of its beneficial winding up.

The expressions "whole turnover agreement" and "facultative agreement" are explained in our answer to question 4.10 below.

---

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)?**

---

A non-assignment clause must be construed to determine precisely what it prohibits. In the first case the prohibition is clear and the assignment of any right or obligation of the seller without the consent of the obligor would be a breach of the restriction. In the second case some textbook writers doubt that the prohibition is absolute and argue that rights or obligations (but not the whole contract) may be assigned without breach of the restriction even if the consent of the obligor is refused. The matter is not free from doubt and we recommend that clear and unambiguous restrictions against assignment be included where so required by the obligor.

However, an English court has construed a non-assignment clause as not precluding a declaration of trust. In that case, the court held that it was the manifest intention of the parties to the assignment that the assignor held the contract on trust for the assignee. The court held further that the declaration of trust cannot prejudice the rights of the obligor and would confer no rights against the obligor on the assignee as beneficiary thereof. Recognition of a trust is an important matter as even the limited rights found by the court should be sufficient to confer potential priority in the event of insolvency of the obligee/assignor.

---

**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in Trinidad and Tobago? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Trinidad and Tobago recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

---

Restrictions in receivables contracts prohibiting the sale or assignment of the contract are enforceable in Trinidad and Tobago. There are no exceptions. A sale by the seller in breach of the prohibition gives no rights to the assignee against the obligor although its terms remain enforceable as between the parties to the assignment. The original seller is the only party entitled to enforce the debt against the obligor. Any notice that the assignee gives to the obligor will have no effect. The obligor would be entitled to damages for breach of contract against the seller (if he can prove any loss) but in practice it is unlikely that any loss would have been suffered other than nominal loss.

---

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

---

The sale document must contain sufficient information so as to

identify clearly each of the debts to be sold. The information required would normally include the name of the obligor and details of the invoice or another document evidencing the debt, i.e. invoice number, invoice date, payment date, the amount of the indebtedness thereunder, and a brief description of the goods or services provided by the seller.

The receivables sold do not have to share objective characteristics but may be a mixed basket of different types of debts. However, to the extent that stamp duty is payable on the sale document, it may be advantageous to group the receivables into different categories according to the rate or rates of duty applicable to each category and apportion the consideration appropriately. In a “whole turnover agreement” where the seller agrees to sell and the purchaser agrees to buy all the seller’s receivables, the sale by the seller of “all” of its debts to the purchaser is sufficient identification of the receivables.

A “whole turnover agreement” would effect a sale of debts where they are clearly identified and not where the client has discretion as to which debts he will sell to the factor. Accordingly, a sale of all receivables other than receivables owing by one or more specifically identified obligors is sufficient identification of receivables.

---

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

---

The authorities suggest that documents drawn up by the parties to record a sale transaction have almost always been accepted as such where the court has been satisfied that they genuinely reflected the intention of the parties, even though the terms used in operating the agreement were such as would ordinarily suggest a loan on security rather than a purchase. The authorities further suggest that the courts are inclined to recognise the right of businessmen to use the business language they understand without having this interpreted as if it were a legal dictionary. This does not prevent the court from investigating the transaction to determine whether it is truly a sale.

- (a) The seller may retain credit risk by providing in the sale agreement for a right of recourse by the purchaser against the seller in the event of default by the obligor.
- (b) The seller may retain interest rate risk by indemnifying the purchaser against any decline in the interest rate.
- (c) The seller may retain control of collection of the receivables by collecting the same as the agent for the purchaser.
- (d) The sale agreement may provide for the repurchase of the debt by the seller in certain circumstances including, but not limited to, the following: (i) where the existence of the debt is disputed by the debtor; (ii) the debtor’s/debtors’ customer rejects the goods and/or services the subject matter of the purchased debt; (iii) the debtor disputes his liability to pay the debt or any part of it and gives as a reason for such dispute any alleged breach by the seller of the contract; or (iv) the existence of any set-off or counterclaim or right to a deduction or any matter which would constitute a breach by the seller of its warranties or covenants in relation to such debt; or (v) if the seller shall accept the return of any goods the subject of a purchased debt; or (vi) if the seller shall be or shall become liable to pass any credit to a customer in respect of the purchased debt.

---

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?**

---

Yes, it can. See our answer to question 4.11.

---

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?**

---

Yes. In a “whole turnover agreement” there is no distinction between receivables that arise prior to, or after, the seller’s insolvency since the transfer of the debts occurs at the date of the agreement and is effective without a further transfer document as soon as the debt comes into existence. In a “facultative agreement”, the seller periodically offers his debts for sale to the purchaser and the purchaser may either accept or decline the offer. The transfer/sale of the debt occurs only when the seller’s offer is accepted by the purchaser. Therefore, in the event of the seller’s insolvency a fixed charge over his debts in favour of a third party subsequent to the date of the facultative agreement will have priority over a later assignment made in furtherance of the facultative agreement.

---

**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

---

The assignment document will normally provide for the transfer of the receivables together with all rights and remedies relating to, or for enforcing, the same including any related security. Once there is a related security, which is also assigned, the assignment must be effected by deed. If the related security is real property or an interest in real property the Deed of Assignment must be registered in the Deeds Registry.

---

**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

---

The assignee takes subject to all equities existing between the seller and the obligor up to the date of giving notice of a sale. The obligor’s rights accrued to that date against the seller are enforceable against the assignee and may be set-off against the debt. Obligor set-off rights that arise against the seller after the date of giving notice of sale to the obligor may not be relied upon by the obligor against the assignee. If the receivables contract does not contain a provision whereby the obligor waives its rights of set-off but the obligor’s set-off rights are terminated due to notice or some

other action, the seller will not be liable to the obligor by reason of such termination unless the assignment was in breach of a restriction against assignment in the receivables contract.

## 5 Security Issues

**5.1 Back-up Security. Is it customary in Trinidad and Tobago to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

No. However it is open to the purchaser out of an abundance of caution to take a security interest in the receivables.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Trinidad and Tobago, and for such security interest to be perfected?**

The security interest may normally be effected by (i) an assignment by way of charge or (ii) an equitable charge on the receivables made by the seller in favour of the purchaser. A fixed equitable charge should normally be supported by an obligation to deposit the receivables into an account controlled by the chargee, otherwise the charge may be deemed only a floating charge. The Deed of Assignment or Deed of Charge is subject to stamp duty at the rate of 0.4 per cent of the amount secured.

If the seller is a company, the purchaser must, within 30 days after the creation of the security interest, register with the Registrar of Companies a statement of charge which sets out certain statutory particulars regarding the security interest together with a copy of the instrument by which the security interest is created. The statement of charge is registered in the official file of the seller at the Registrar of Companies.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Trinidad and Tobago to grant and perfect a security interest in purchased receivables governed by the laws of Trinidad and Tobago and the related security?**

The same security documents and formalities as set out in the response to question 5.2 above will apply. Assuming that the purchaser is a Trinidad and Tobago company the statement of charge is registered in the official file of the purchaser. Notice of any further assignment must be given to the obligor.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Trinidad and Tobago, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Trinidad and Tobago or must additional steps be taken in Trinidad and Tobago?**

Yes. If the purchaser is an overseas company no formalities are required in Trinidad and Tobago except that notice of any further assignment must be given to the obligor. If the purchaser is a Trinidad and Tobago company a statement of charge must be registered in the official file of the purchaser and notice of any further assignment given to the obligor.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

No additional or different requirements apply except in the case of a loan secured by a mortgage of real property. In that case the Deed of Mortgage or Deed of Assignment of Mortgage must be registered in the Deeds Registry.

**5.6 Trusts. Does Trinidad and Tobago recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Trinidad and Tobago law recognises the concept of trust.

**5.7 Bank Accounts. Does Trinidad and Tobago recognise escrow accounts? Can security be taken over a bank account located in Trinidad and Tobago? If so, what is the typical method? Would courts in Trinidad and Tobago recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in Trinidad and Tobago?**

Trinidad and Tobago recognises escrow accounts. A charge on the interest of a Trinidad party in an escrow account is effective over the chargor's interest therein, subject however to the terms and conditions governing the escrow.

Security can be taken over a bank account located in Trinidad and Tobago. The typical method is a specific account charge or a general charge under a charging document such as a debenture on the property of a company.

The courts in Trinidad and Tobago would recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Trinidad and Tobago. If the chargor is a Trinidad company, a statement of charge must be registered in the official file.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

Yes, the secured party is entitled to control all cash flowing into the bank account after enforcement until the secured party is repaid in full. It is normal practice to provide in the document which creates the charge over the account that the secured party is irrevocably authorised without notice to the owner of the account to appropriate the whole or part of the funds in, or towards, payment or discharge of any or all of the secured indebtedness.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

In Trinidad and Tobago security over a bank account can be created by way of fixed or floating charge. A floating charge is not a very effective form of security as there would be little or no restriction on withdrawals from the account by the account holder prior to the

floating charge being crystallised into a fixed charge. As a consequence it is normal practice in Trinidad and Tobago that a charge over a bank account is created by a fixed charge under which the secured party has effective control over the account. In particular, the charge would include a provision which prohibits the owner of the account from withdrawing the funds in the account without the consent of the secured party. See also the answer to questions 5.7 and 5.8 above.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Trinidad and Tobago's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

Neither the Companies Act, Chap. 81:01 ("Companies Act") nor the Bankruptcy Act provide for an "automatic stay". Under Section 436 of the Companies Act certain transactions relating to property which would, if made or done by, or against an individual, be deemed in his bankruptcy a fraudulent preference, or a fraudulent conveyance, assignment, transfer, sale or disposition, shall if made or done by or against a company, be deemed, in the event of its being wound up, a fraudulent conveyance, assignment, transfer, sale or disposition, as the case may be and be invalid accordingly.

Section 48 (1) of the Bankruptcy Act provides that every conveyance or transfer of property, or charge thereon made, every payment made, every obligation incurred, and every judicial proceeding taken by any person unable to pay his debts as they become due from his own money in favour of any creditor, or of any person in trust for any creditor, with a view to giving such creditor, or any surety or guarantor for the debt due to such creditor, a preference over the other creditors, shall, if the person making, taking, paying or suffering the same is adjudged bankrupt on a petition presented within three months after the date of making, taking, paying or suffering the same, be deemed fraudulent and void as against the trustee in bankruptcy. The insolvency official does not have any inherent power to stay collection and enforcement actions but must seek assistance from the court as provided in the response to question 6.2 below.

The provisions relating to fraudulent preferences apply to sales and charges. Therefore, the transaction may be set aside as a fraudulent preference whether it is deemed a sale or a security.

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

The insolvency official may apply to the court for an injunction to prohibit or stay the purchaser's exercise of rights on the ground that the transaction is a fraudulent preference. The purchaser will be entitled to contest the application. The court has the discretion whether or not to grant the injunction, stay or any other appropriate relief. In urgent cases, interim injunctions may be granted.

The insolvency official may, subject to the provisions of the Companies Act, also disclaim the agreement as an unprofitable contract.

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Trinidad and Tobago for (a) transactions between unrelated parties, and (b) transactions between related parties?**

The following conditions must be fulfilled:

1. The seller must, at the date of the transaction, be unable to pay from his own money his debts as they fall due.
2. The transaction must be in favour of a creditor, or some person in trust for a creditor.
3. The seller must have acted with the view of giving such creditor or a surety or guarantor for the debt due to such creditor a preference over his other creditors.
4. The seller must be adjudged insolvent on a petition presented within three calendar months after the date of the transaction sought to be impeached.

Pursuant to Section 48 of the Bankruptcy Act and Section 436 of the Companies Act, the "suspect" or "preference period" is three months before the commencement of the insolvency proceedings of the company. There is no distinction made in the legislation between related and unrelated parties with respect to the preference period. For the purposes of this section, the commencement of the winding up is deemed to correspond with the presentation of the bankruptcy petition in the case of an individual.

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

There is no provision for the consolidation of assets and liabilities of the purchaser with those of the seller or its affiliates in insolvency proceedings by the insolvency official.

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Trinidad and Tobago, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

In a facultative agreement (discussed in our response to question 4.10 above), the transfer of the future receivables occurs when the seller's offer to sell a specific receivable is accepted by the purchaser. Hence, the purchaser's right to the future receivables arises only at the time of the sale of the debts in furtherance of the facultative agreement. Therefore, where the sale of the receivables has not occurred on the initiation of insolvency proceedings, the receivables remain the property of the seller and will on application by the liquidator, vest in the liquidator.

In a "whole turnover agreement" the purchaser is entitled to the ownership of the debts vesting in him at the time of the order or resolution for insolvency. These debts will include not only those debts notified to him, but also all those debts specified in the

agreement and earned by the performance of the relevant contract of sale or service by the company. Debts earned by performance by the liquidator in compulsory or creditors' voluntary liquidation will not vest in the purchaser even if they arise under contracts in existence before the liquidator's appointment.

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

Where the debtor's contracts contain a limited recourse provision similar to that set forth in question 7.3 below, the debtor would not be declared insolvent on the grounds that it cannot pay its debts as they become due; as the parties have agreed that any shortfall in payment will be deemed extinguished, the debtor has no debt. Nothing prevents the debtor from being deemed insolvent on this ground by reason of other debts for which there is no limited recourse provision.

## 7 Special Rules

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Trinidad and Tobago establishing a legal framework for securitisation transactions? If so, what are the basics?**

No. However some provisions of the Securities Industry Act 2012 (Securities Act) may be applicable to securitisation transactions to the extent that any such transactions involve the sale or offer for sale or distribution of securities (as defined in the Securities Act). The Securities Act provides for regulatory oversight by the Trinidad and Tobago Securities and Exchange Commission in relation to the trading in asset backed securities by way of the grant of exemptions from the issue of a prospectus.

**7.2 Securitisation Entities. Does Trinidad and Tobago have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

No, it does not.

**7.3 Limited-Recourse Clause. Will a court in Trinidad and Tobago give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

The Trinidad and Tobago courts will enforce a contract limiting the recourse of parties to that agreement to the available assets of the debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished, even if the contract is governed by a foreign law. The courts will enforce a limited recourse provision in those terms, once they are satisfied that the relevant provision is valid and enforceable under the foreign law and such

enforcement would not be illegal under Trinidad and Tobago law or contrary to local public policy. Under current law and public policy such a provision is not intrinsically void or voidable and avoidance of the provision would have to be supported by other grounds, e.g. if the contract was deemed to be a fraudulent preference.

**7.4 Non-Petition Clause. Will a court in Trinidad and Tobago give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

In the context of enforcement of foreign law, contracts discussed at question 7.3 above, a provision prohibiting the parties from taking legal action against the purchaser or another person will be enforced by the Trinidad and Tobago courts. There may be some doubt as to enforceability of a provision prohibiting commencement of an insolvency proceedings against the purchaser or another person. (See our response to question 7.6 below.)

**7.5 Priority of Payments "Waterfall". Will a court in Trinidad and Tobago give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

Yes. A Court in Trinidad and Tobago will normally give effect to a contractual provision in an agreement (even if the contract's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract. A possible exception would be the case discussed in our answer to question 3.2 above where, on insolvency of a Trinidad and Tobago seller, a court may deem the contract to be a fraudulent preference of the creditors to whom the distribution is made.

**7.6 Independent Director. Will a court in Trinidad and Tobago give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

Yes. A Trinidad and Tobago court will normally enforce a contractual provision in an agreement (even if the contract's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions without the affirmative vote of an independent director. However, an undertaking not to commence or a restriction against commencement of insolvency proceedings may be unenforceable. Firstly, directors may incur personal liability to creditors and shareholders if an insolvent entity continues trading so that a court is unlikely to prevent them from instituting insolvency proceedings in a proper case. Secondly, such an undertaking or restriction may be considered to be against public policy.

## 8 Regulatory Issues

- 8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Trinidad and Tobago, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Trinidad and Tobago? Does the answer to the preceding question change if the purchaser does business with other sellers in Trinidad and Tobago?**

Except for entities that, by reason of the nature of their business, are subject to licensing or minimum capitalisation requirements, there are no qualification criteria for an entity to do business in Trinidad and Tobago. A single transaction involving the purchase and ownership of specific receivables by a non-resident purchaser who has no other business in Trinidad and Tobago, will not be deemed as carrying on business in Trinidad and Tobago, nor will the purchaser be subject to regulation as a financial institution. If the non-resident purchaser engages in several similar transactions with different sellers or enters into a transaction for continuous purchase of receivables for an extended period from the same seller, it is likely that he would be deemed to be carrying on (i) business in Trinidad and Tobago for tax purposes, and (ii) business of a financial nature under the Financial Institutions Act which requires a licence under that Act.

- 8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

No licence is required by the seller under Trinidad and Tobago law. Once notice of assignment has been given to the obligor, the seller is not entitled to collect or enforce in his own right and would have to be acting as an agent of the purchaser.

- 8.3 Data Protection. Does Trinidad and Tobago have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

One of the fundamental rights under the Constitution of Trinidad and Tobago is an individual's right to privacy. There are some limited privacy rights under common law. The banker-client relationship also gives rise to obligations of confidentiality on the part of the bank. There are no laws in Trinidad and Tobago which specifically deal with the use or dissemination of data provided by obligors. The Data Protection Act 2011 provides, *inter alia*, for the protection of personal privacy and information by the private sector, the government and public authorities.

- 8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Trinidad and Tobago? Briefly, what is required?**

There are no applicable laws in Trinidad and Tobago except that local bankers have adopted a Code of Banking Practice for dealings with customers that includes some provision for a general duty of confidentiality towards their customers.

- 8.5 Currency Restrictions. Does Trinidad and Tobago have laws restricting the exchange of Trinidad and Tobago's currency for other currencies or the making of payments in Trinidad and Tobago's currency to persons outside the country?**

There are no exchange control restrictions in Trinidad and Tobago. Payments in Trinidad and Tobago currency are made locally and payments to persons outside the country are made in foreign currency.

## 9 Taxation

- 9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Trinidad and Tobago? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

Yes. Interest paid by a resident obligor to a non-resident purchaser is subject to withholding tax which is required to be deducted at source by the payer and paid to the revenue authority. The standard rate of withholding tax is 15 per cent or such lower rate as may be provided in any double taxation treaty between Trinidad and Tobago and the purchaser's country of residence. The receivables contract will often provide for grossing up payments that are subject to withholding tax so that after deduction of withholding tax at the applicable rate the payee will receive the specified amount of interest. In the absence of a grossing up provision the payee will receive the specified amount minus the tax. Where there is a double taxation treaty the payee may be entitled to a tax credit in his country of residence for the tax deducted and paid in Trinidad and Tobago.

In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, only that part of the deferred purchase price which comprises interest will be treated as such for tax purposes. The possibility exists that the revenue authority may characterise a matter as it chooses, but if the transaction is defensible from a financial reporting standards perspective this will be highly persuasive in court (in other words, if Chartered Accountants do not classify it as interest, then the revenue authority ought not to classify it as interest).

- 9.2 Seller Tax Accounting. Does Trinidad and Tobago require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

No, it does not.

- 9.3 Stamp Duty, etc. Does Trinidad and Tobago impose stamp duty or other documentary taxes on sales of receivables?**

Yes. A Deed of Assignment is chargeable with stamp duty as a Conveyance on Sale at rates varying between 2 per cent, 5 per cent and 7 per cent of the consideration. Some receivables may be exempt from stamp duty, e.g., promissory notes or debt instruments or securities of specifically exempted entities, and others, e.g., mortgage loans or bonds, may be subject to a different rate of 0.5 per cent. In

such cases it is recommended that separate considerations for each different type of security be stated in the assignment in order to take advantage of such exemptions or lower rate.

---

**9.4 Value Added Taxes. Does Trinidad and Tobago impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

---

The Value Added Tax Act (“the Act”) imposes value added tax (“VAT”) at the rate of 15 per cent on the sale of goods and services by a registered supplier. A supplier in receipt of gross sales or income in excess of TT\$360,000 in a twelve-month period is required to be registered under the Act. The sale of receivables is deemed a “financial service” under the Act and is VAT-exempt. The services of the collection agent are subject to VAT once he is registered under the Act.

---

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

---

VAT is not chargeable.

Stamp duty is payable by the purchaser. The taxing authority will not make claims for the unpaid duty against the purchaser or the sold receivables or collections but the Deed of Assignment cannot be received, filed, used or admitted into evidence in a Trinidad court until it is properly stamped. Therefore, in the event of a dispute the purchaser will have difficulty in establishing his title to the receivables or collections if the Deed of Assignment or other applicable transaction documents are unstamped.

---

**9.6 Doing Business. Assuming that the purchaser conducts no other business in Trinidad and Tobago, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Trinidad and Tobago?**

---

The sale of receivables constitutes the sale of an asset in Trinidad and Tobago. No income tax or corporation tax is payable by the purchaser on transaction gains so long as the purchaser is not deemed to be carrying on business in the territory. We have discussed the issue of the payment of withholding tax above.

### Cautionary Statement

The Parliament of Trinidad and Tobago has enacted the Bankruptcy and Insolvency Act 2007 which repeals the Bankruptcy Act. The new act will come into force on proclamation but it has not yet been proclaimed and we have no indication when this will be done. We caution that the provisions of the new act, when proclaimed, may require variation of the responses to some of the questions herein, especially those relating to bankruptcy or insolvency of a party.

**William David Clarke**

J.D. Sellier + Co.  
129-131 Abercromby Street  
Port of Spain  
Trinidad and Tobago

*Tel:* +1 868 623 4283  
*Fax:* +1 868 625 2984  
*Email:* [wclarke@jdsellier.com](mailto:wclarke@jdsellier.com)  
*URL:* [www.jdsellier.com](http://www.jdsellier.com)

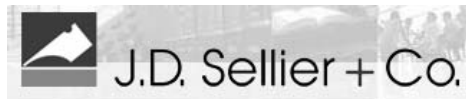
David Clarke joined the firm in 1969. He represents the firm's clients in a wide range of commercial transactions, in particular the establishment of large commercial or industrial projects including: the preparation and approval of material project contracts on behalf of project parties; project financing through local and international lenders; mergers and acquisitions; joint ventures; takeovers; land development projects; insurance; and corporate governance. David renders general corporate or commercial advice and advice on environmental issues. He also acts for both lenders and borrowers in a range of facilities in banking and finance.

**Donna-Marie Johnson**

J.D. Sellier + Co.  
129-131 Abercromby Street  
Port of Spain  
Trinidad and Tobago

*Tel:* +1 868 623 4283  
*Fax:* +1 868 625 2984  
*Email:* [djohnson@jdsellier.com](mailto:djohnson@jdsellier.com)  
*URL:* [www.jdsellier.com](http://www.jdsellier.com)

Donna-Marie Johnson joined the Corporate + Commercial department of J.D. Sellier in March 2008 as a Senior Associate and offers years of valuable experience. Having worked for various organisations for most of her career, she has a clear understanding of an organisation's needs and the Corporate Attorney's deliverables to the corporate client. Ms. Johnson also heads the Estate Planning and Administration department at J.D. Sellier.  
Practice Areas: Banking & Finance; Mergers and Acquisitions; Joint Ventures; Estate Planning; and Administration.



J.D. Sellier + Co. is a general service law firm specialising in four (4) areas of civil practice, namely Corporate + Commercial (including Tax), Real Estate, Intellectual Property; and Litigation + Dispute Resolution. Our clients include industrial and commercial enterprises, domestic and foreign, public and private, ranging in size and complexity from small location business enterprises to large diverse, multinational corporations.

Employees at J.D. Sellier are committed to creating client value and to maintaining service excellence in an atmosphere of mutual respect and trust.



# USA



Lawrence Safran



Kevin T. Fingeret

## Latham & Watkins LLP

### Note

The answers to the questions in sections 1 and 2 generally describe the rules provided by the Uniform Commercial Code (“UCC”), a model statute enacted with some variations in each state, and the answer to question 4.10 and the questions in section 6 generally describe the rules provided by the U.S. Bankruptcy Code, in each case unless otherwise specified. The United States is a signatory to, but has not yet ratified, the United Nations Convention on the Assignment of Receivables in International Trade (the “UNCITRAL Convention”). It is anticipated that the United States may ratify the UNCITRAL Convention in the near future. Upon the effectiveness thereof, the UNCITRAL Convention would override the UCC and change many of the answers set forth herein.

The United States contains multiple jurisdictions with varying statutory laws, regulations and judicial precedent, in general, where the laws of a particular United States jurisdiction are relevant, the following answers assume that the law of the state of New York applies.

### 1 Receivables Contracts

**1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

With respect to a contract for the sale of goods for \$500 or more, some writing sufficient to indicate that a contract for sale has been made is required. A contract for services is generally required to be in writing if, by its terms, it is not to be completed within one year. However, with respect to contracts for sales of goods, a formal sales contract is not required but rather a contract may be on the basis of exchanged purchase orders, general terms, and invoices, or by a combination of writings which are themselves insufficient to establish a contract coupled with the conduct by both parties which recognises the existence of a contract.

**1.2 Consumer Protections. Do the USA’s laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

(a) Each state has different limitations on the permissible rate of interest; however, U.S. federal law permits banks and some other depository institutions to use a uniform nationwide rate, determined by the law of the state where the principal office of the institution is located.

(b) Not to our knowledge.

(c) Certain jurisdictions provide consumers with a period of time to cancel certain types of transactions after entering into a contract, in some cases, these rights only apply when the contract was entered into in a specified context (*e.g.*, when a contract is entered into with a merchant other than at a merchant’s regular place of business).

(d) Consumers benefit from a number of protections. For example, restrictions on assignment of consumer loans are generally enforceable. In addition, personally identifiable consumer information cannot be disclosed or used other than in specified manners.

Federal and state consumer protection laws and regulations regulate the relationships among credit card members, credit card issuers and sellers of merchandise and services in transactions financed by the extension of credit under credit accounts. These laws and regulations include the Credit Card Accountability and Disclosure Act, the Federal Truth-in-Lending Act and Fair Credit Billing Act, and the provisions of the Federal Reserve Board’s Regulation Z issued under each of them, the Equal Credit Opportunity Act and the provisions of the Federal Reserve Board’s Regulation B issued under it, the Fair Credit Reporting Act and the Fair Debt Collection Practices Act. These statutes and regulations require credit disclosures on credit card applications and solicitations, on an initial disclosure statement required to be provided when a credit card account is first opened, and with each monthly billing statement. They also prohibit certain discriminatory practices in extending credit, impose certain limitations on the charges that may be imposed and regulate collection practices. In addition, these laws and regulations entitle card members to have payments and credits promptly applied on credit accounts and to require billing errors to be promptly resolved. The Credit Card Accountability and Disclosure Act and the provisions of the regulations that implemented it limit the ability of credit card issuers to increase the interest rates on existing credit card balances, regulate

how interest is calculated for each billing cycle, and regulate how payments must be allocated to outstanding balances with different interest rates. A card member may be entitled to assert violations of certain of these consumer protection laws and, in certain cases, claims against the lender or seller, by way of set-off against his or her obligation to pay amounts owing on his account. For example, under the Federal Truth-in-Lending Act, a credit card issuer is subject to all claims, other than tort claims, and all defences arising out of transactions in which a credit card is used to purchase merchandise or services, if certain conditions are met. These conditions include requirements that the card member make a good faith attempt to obtain satisfactory resolution of the dispute from the person honouring the credit card and meet certain jurisdictional requirements. These jurisdictional requirements do not apply where the seller of the goods or services is the same party as the card issuer, or controls or is controlled by the card issuer directly or indirectly. These laws also provide that in certain cases a card member's liability may not exceed \$50 with respect to charges to the credit card account that resulted from unauthorised use of the credit card. In addition, the Dodd-Frank Act became federal law in 2010 and contains numerous regulations relating to the financial industry and provides for the establishment of the Bureau of Consumer Financial Protection. It is not yet clear how implementation of the Dodd-Frank Act will affect consumer receivables.

The Servicemembers Civil Relief Act allows individuals on active duty in the military to cap the interest rate and fees on debts incurred before the call to active duty at 6 percent. In addition, subject to judicial discretion, any action or court proceeding in which an individual in military service is involved may be stayed if the individual's rights would be prejudiced by denial of such a stay. Currently, some account holders with outstanding balances have been placed on active duty in the military, and more may be placed on active duty in the future.

**1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

Yes, if the debtor is the U.S. government or one of its agencies or instrumentalities. In such a case the Federal Assignment of Claims Act will apply to an assignment of receivables and the right of the federal government to exercise set-off. A minority of states have similar laws that apply to obligations of the state or agencies or departments thereof and a few states extend such rules to municipalities and other local governmental entities.

## 2 Choice of Law - Receivables Contracts

**2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in the USA that will determine the governing law of the contract?**

Courts generally apply the choice of law rules of the state in which the court is located, and thus answers to choice of law questions may differ depending on the state in which the litigation is prosecuted. Under the Restatement 2nd of Conflicts of Law, the rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties. In the absence of an effective choice of law by the parties, the contacts to be taken into account in determining the law applicable to an issue

include: (a) the place of contracting; (b) the place of negotiation of the contract; (c) the place of performance; (d) the location of the subject matter of the contract; and (e) the domicile, residence, nationality, place of incorporation and place of business of the parties.

**2.2 Base Case. If the seller and the obligor are both resident in the USA, and the transactions giving rise to the receivables and the payment of the receivables take place in the USA, and the seller and the obligor choose the law of the USA to govern the receivables contract, is there any reason why a court in the USA would not give effect to their choice of law?**

The U.S. is a multi-jurisdictional country and the contract needs to select the law of a particular U.S. state (rather than federal law) as the governing law. The choice of the law of a particular state of the United States to govern a contract may not be given effect if it does not bear a reasonable relationship with the transaction or parties. A few states, such as New York, permit the choice of their law to govern a contract even in the absence of any contacts if the contract satisfies certain dollar thresholds; however another U.S. state may not respect this choice of law if litigated in the other U.S. state in the absence of a reasonable relationship. Of course, on the facts specified above, there is no reason that an effective choice of a U.S. state law cannot be made.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in the USA but the obligor is not, or if the obligor is resident in the USA but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in the USA give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

In general, the choice of law of the parties will be given effect in the circumstances described above. However, each state has somewhat different considerations in determining whether to give effect to a choice of non-U.S. law. Typically such a choice of non-U.S. law will be given effect if: (i) the chosen law has a reasonable and substantial relationship and sufficient contacts with the underlying agreement or the transaction contemplated thereby, and the chosen law has the most significant contacts with the matter in dispute; (ii) the chosen law does not violate or contravene, nor is contrary or offensive to, a public or fundamental policy of the state or of such other jurisdiction whose law would apply in the absence of an effective choice of law by the parties to the underlying agreement (which may be another U.S. state or a foreign jurisdiction); (iii) the chosen law was not induced or procured by fraud; and (iv) the matter of law for which the chosen law is to be applied has been previously addressed by the chosen law and the chosen law differs from the law that would be applied in the absence of the chosen law. Under the Restatement 2nd of Conflicts of Law, a court may decline to apply the law of a jurisdiction chosen by the parties to a contract (which may be another U.S. state or a foreign jurisdiction) when (1) it is necessary to protect the fundamental policies of the state, the law of which would otherwise apply, and (2) such state has a materially greater interest in the determination of a particular issue than the state of the chosen law. It is not possible to make a definitive statement of when the fundamental policy exception would apply since each U.S. state and each court will reach its own determinations on a case-by-case basis.

## 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in the USA?

Yes, it is.

## 3 Choice of Law - Receivables Purchase Agreement

### 3.1 Base Case. Does the USA's law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., the USA's laws or foreign laws)?

Generally, there is no reason that the law of the state governing the contract giving rise to the receivables needs to be the same as the law of the state governing the sale of the receivables. However, as noted below in response to question 3.4, the sale of the receivables will need to be perfected under the Uniform Commercial Code and the law governing perfection cannot be selected by the parties but, instead, is subject to mandatory choice of law rules.

### 3.2 Example 1: If (a) the seller and the obligor are located in the USA, (b) the receivable is governed by the law of the USA, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the USA to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the USA, will a court in the USA recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Generally yes, subject to the same considerations referenced in the response to question 2.3 above.

### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside the USA, will a court in the USA recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

Generally yes, subject to the same considerations referenced in the response to question 2.3 above.

### 3.4 Example 3: If (a) the seller is located in the USA but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in the USA recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with the USA's own sale requirements?

Subject to the considerations discussed in the response to question 2.3 above, a court in a United States jurisdiction will generally recognise the foreign law determination of whether a "true" sale has

occurred as between the parties to the transaction pursuant to which the receivables were sold. However, any transfer of receivables, whether it is characterised as an outright sale or as a conditional transfer for security is classified under the UCC as a "security interest" and such security interest would need to be "perfected" in order to be enforceable against other creditors of the seller and any bankruptcy trustee of the seller. The methods of perfecting this security interest are detailed in the response to question 4.3 below. However, the law governing perfection may not be selected by the parties but rather is subject to mandatory choice of law rules. Where perfection is obtained by the filing of UCC financing statements, the law of the seller's "location" generally governs perfection of a non-possessory security interest in receivables. A seller's location is determined according to a number of factors, including: (a) the type of organisation (e.g. corporation, limited partnership or general partnership); (b) whether it is formed under the laws of a foreign country; (c) the location of its chief executive office; and (d) whether the law of the jurisdiction in which its chief executive office is located provides a system of public filing of notices of non-possessory liens on personal property as a condition for having priority over a judgment lien creditor. Although there are some exceptions, for most corporations and limited liability companies that are organised under the laws of any state of the United States, their "location" for purposes of the UCC (and hence the law governing perfection by filing) will be their state of incorporation.

Where perfection is obtained by possession of the original promissory note or tangible "chattel paper" evidencing the receivable, the law of the jurisdiction where the promissory note or tangible chattel paper is physically located will govern perfection of a possessory security interest. Examples of chattel paper include leases of office equipment, retail auto leases, and many retail instalment sales contracts.

### 3.5 Example 4: If (a) the obligor is located in the USA but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in the USA recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with the USA's own sale requirements?

Generally, yes.

### 3.6 Example 5: If (a) the seller is located in the USA (irrespective of the obligor's location), (b) the receivable is governed by the law of the USA, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in the USA recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in the USA and any third party creditor or insolvency administrator of any such obligor)?

The answer to this question will generally be the same as the answer to question 3.4 above.

## 4 Asset Sales

### 4.1 Sale Methods Generally. In the USA what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

Sales of receivables in securitisation transactions are generally structured as outright sales of all of the seller's right, title and interest in, to and under the receivables and the related assets, and all proceeds of the foregoing. The transfer is valid and enforceable if the purchaser gives value, the seller owns or has the power to sell the accounts receivable and the sale is evidenced by an otherwise binding and enforceable contract. However, whether the transfer will be respected as a "true sale" or re-characterised as a security interest will depend on a number of factors discussed below in question 4.8. Sale terminology is customarily used to refer to these transactions, although governing documents will often use a combination of terms as a precaution.

### 4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

For sales of types of receivables not covered by the answer to question 4.3, the sale is perfected by the filing of a UCC financing statement that identifies the seller, the purchaser and the receivables being sold. The financing statement must be filed in the appropriate filing office of the jurisdiction in which the seller is "located" – determined as provided in the answer to question 3.4.

### 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

Receivables evidenced by promissory notes or negotiable instrument, or that constitute "payment intangibles", "chattel paper", or "marketable securities", all have different perfection rules.

#### Promissory Notes

A sale of "promissory notes" (most residential and commercial mortgage loans are evidenced by promissory notes) is automatically perfected, and no UCC financing statement needs to be filed or other action needs to be taken to perfect the sale. However, automatic perfection would not be applicable in the event that the sale was re-characterised as a security interest rather than a true sale and, accordingly, to protect against this risk, it is customary for a buyer to either take possession of the promissory notes or file a UCC financing statement to ensure that the buyer is perfected in the event of such a re-characterisation. In addition, if the purchaser fails to take possession of promissory notes it may be possible for another party who takes possession to obtain superior rights in the promissory notes. In the United States, most mortgage loans are evidenced by promissory notes.

#### Payment Intangibles

Mortgage loans that are not evidenced by promissory notes or other instruments are classified under the UCC as "payment intangibles" and are also automatically perfected. Again, it is customary to perfect by filing a financing statement to protect against the risk of

re-characterisation of the sale as a security interest rather than a true sale. A "payment intangible" is a type of "general intangible" under the UCC, and perfection of security interests in other types of general intangibles can be perfected only by filing a UCC financing statement.

#### Chattel Paper

In contrast to promissory notes and payment intangibles, a sale of chattel paper must be perfected regardless of whether characterised as a sale or a more traditional security interest. A sale of "tangible" chattel paper (*i.e.*, evidence by traditional, hard copy writing) may be perfected either by filing a UCC financing statement or by the purchaser (or its agent) taking possession of the chattel paper. A sale of "electronic" chattel paper may be perfected either by filing a UCC financing statement or by the purchaser taking control of the chattel paper. In the case of conflicting security interests, a purchaser that gives new value and takes possession (or control in the case of electronic chattel paper) of the chattel paper in good faith, in the ordinary course of the purchaser's business, and without knowledge that doing so violates the rights of another party, will have priority over a purchaser that perfects by filing.

#### Marketable Debt Securities

Sales of marketable debt securities are governed by Article 8 of the UCC, rather than as a "secured transaction" under Article 9 of the UCC. A purchaser that gives value and obtains "control" of the securities, without notice of any adverse claim, is a "protected purchaser" of the securities. A protected purchaser's ownership interest will be free from attack by any other person claiming a security interest or other property interest in the securities. The necessary steps to achieving "control" over marketable debt securities involve (a) in the case of certificated securities, taking possession of such securities together with a written assignment executed by the seller, (b) in the case of uncertificated securities, either (i) having the securities transferred on the books and records of the issuer into the name of the purchaser, or (ii) having the issuer agree that it will follow the purchaser's instructions regarding disposition or redemption of the securities being sold without the further consent of the seller, and (c) in the case of securities maintained in a securities account, either (i) having the securities transferred and credited to the purchaser's own securities account, or (ii) having a securities intermediary that maintains the securities account to which the securities are credited agree that it will follow the purchaser's instructions regarding disposition or redemption of the securities being sold without the further consent of the seller.

### 4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if: (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

Obligor notification is not required in order for a sale of the sellers' rights in respect of the receivable to be effective as between the seller and the purchaser. However, the general rule under the UCC is that only once the obligor receives notice that the receivable has been sold: (i) can the purchaser enforce the payment obligation

directly against the obligor; and (ii) must the obligor pay the purchaser in order to be relieved of its payment obligation. In addition, notifying the underlying obligor of the assignment has the advantage of preventing such obligor from exercising against the purchaser a right of set-off or defence that the obligor might have had against the seller and that accrues after the obligor receives notice of the assignment (although an obligor always retains the right of recoupment arising from the transaction that gave rise to the receivable) and, in those cases where the receivable has been fully earned by performance, prevents any amendment to the receivables contract without the consent of the purchaser. If, alternatively, the receivables are evidenced by a “negotiable instrument”, a purchaser who becomes a holder in due course may enforce directly against the obligor and takes free and clear of defences arising from the seller’s conduct, subject to a few exceptions under consumer protection laws. Similar rights are available to protected purchasers of debt securities.

Generally, a seller or obligor insolvency will not limit the ability of the purchaser of receivables to give notice to the obligors of the assignment of those receivables. The purpose of the notification requirement is to avoid the obligor being required to pay twice.

Unless the contract expressly requires such consent, obligor consent is generally not required under U.S. common law in order for a sale of the seller’s rights in respect of the receivable to be effective as between the seller and the purchaser. The answer to the question of whether the language of the receivables contract changes the general rule depends upon the type of receivables involved. Generally, under the UCC, a provision in a non-consumer account receivable and certain other types of receivables which prohibits or restricts its sale, or which provides that a sale may give rise to a default, breach, right of recoupment, claim, defence, termination or remedy, is ineffective. However, the UCC provides that if a receivable containing such a prohibition is evidenced by a “promissory note” or is classified under the UCC as a “payment intangible”, although the sale is effective as between the purchaser and the seller the purchaser cannot enforce the receivable against the obligor and the sale does not impose any duty or obligation on the obligor.

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

As noted in the response to question 4.4 above, notice to the obligor is required only to the extent of imposing certain obligations on the obligor. There is no specific form specified for delivery of notice other than that the notice must be an “authenticated record”, *i.e.*, in a signed writing or the electronic equivalent thereof. Generally, there is no time limit for the delivery of such a notice, though, as noted above, there are advantages in giving the notice sooner rather than later and a seller or obligor insolvency should not limit the ability of the purchaser of receivables to give notice to the obligors of the assignment of those receivables, so long as the assignment was fully consummated before the commencement of the insolvency proceeding. The purpose of the notification requirement is to avoid the obligor being required to pay twice. A notice to an

obligor need not be limited to a specific set of receivables and can cover future receivables as long as those receivables are identifiable.

**4.6 Restrictions on Assignment - General Interpretation. Will a restriction in a receivables contract to the effect that “None of the [seller’s] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]” be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says “This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]” (i.e., the restriction does not refer to rights or obligations)?**

Generally, a restriction prohibiting the transfer or assignment of seller’s rights or obligations under an Agreement without the consent of the obligor will likely be interpreted as prohibiting the assignment of rights and the delegation of duties of the seller under such an agreement. However, under the UCC, such restrictions will not be effective to prevent the granting of a security interest or the sale of a receivable, though, as noted in the answer to question 4.4, in some cases such security interest will be unenforceable against the underlying obligor.

**4.7 Restrictions on Assignment; Liability to Obligor. If either or both of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables under the receivables contract, are such restrictions generally enforceable in the USA? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If the USA recognises restrictions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?**

Generally, such restrictions will not be effective to prevent the granting of the security interest, though, as noted in the answer to question 4.4, in some cases such security interest will be unenforceable against the underlying obligor.

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells *all* of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells *all* of its receivables *other than* receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

No, the sale document need not specifically identify each receivable to be sold, but it must nonetheless provide a means for identifying objectively receivables that have been sold. Under the UCC, a security interest can be created in a broad category of assets (such as accounts receivable). If all receivables have been sold, no further identification should be required.

If all receivables have been sold other than receivables owing by one or more specifically identified obligors, a description of collateral referencing all receivables (other than certain clearly identified excluded receivables) can be an adequate description of collateral.

**4.9 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

Whether a receivables transfer will be recognised as a “true sale” (and not as a secured loan), in most states it is determined by judge-made common law. As a result, judicial authority analysing transfers as true sales is not always consistent. Several courts have given presumptive weight to the intent of the parties. Other courts, seeking the “true nature” of a transaction, have regarded the parties’ intent as only one attribute of a transaction and have balanced those attributes of a transaction indicative of a secured loan against those attributes indicative of a sale in order to determine whether the transaction more closely resembles a sale or a secured loan. Where commercially sophisticated parties have characterised transactions as sales, and acted consistently with that characterisation, courts have generally been unwilling to disturb that characterisation even though the transactions may also bear certain attributes of secured loans. Upon a showing by “clear and convincing evidence”, however, that the transaction had the economic substance of a “disguised financing”, courts may invoke their equitable power to re-characterise the transaction accordingly.

Generally, a key element to finding that a sale took place, as opposed to a loan, is that recourse to the seller is limited or non-existent. Recourse to the seller can take several forms. Recourse for the uncollectibility of the receivables and recourse to provide a contracted rate of return are often cited in cases re-characterising transactions as loans.

While not necessarily dispositive, a right of repurchase may adversely affect the characterisation of the transaction as a true sale.

**4.10 Continuous Sales of Receivables.** Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes, a seller can agree to continuous sales of receivables in the U.S.; however, the bankruptcy code will generally cut-off the purchaser’s interest in any receivables that are generated after the seller files for bankruptcy.

**4.11 Future Receivables.** Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Prior to insolvency, yes, as long as the receivables in question are sufficiently specified by the sale agreement. The effectiveness of sales of receivables arising after the bankruptcy of the seller could be uncertain. If both the seller and the purchaser have continuing duties to perform, the agreement could constitute an “executory contract” which may be rejected by the seller’s bankruptcy trustee.

**4.12 Related Security.** Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Generally, attachment and perfection of a security interest or sale of receivables in accordance with the formalities described in the answers to questions 4.1, 4.2 and 4.3 will result in automatic attachment and perfection of a security interest in a security interest securing the receivable, the related security or any letter of credit supporting payment of such receivable.

**4.13 Set-Off; Liability to Obligor.** Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?

No, the secured party will always take subject to the right of recoupment and the rights of set-off under the contract. However, the right to set-off will only be effective with respect to claims accruing prior to the obligor’s receipt of a notice of assignment. The obligor’s claims against the assignee are limited to the amount the obligor owes the assignee.

## 5 Security Issues

**5.1 Back-up Security.** Is it customary in the USA to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

Yes, it is customary.

**5.2 Seller Security.** If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of the USA, and for such security interest to be perfected?

As described in the answers to questions 4.2 and 4.3, the grant of a security interest in a receivable is generally perfected by the filing of a UCC financing statement. For instruments and chattel paper, possession of the original is also available as a method of perfection.

**5.3 Purchaser Security.** If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in the USA to grant and perfect a security interest in purchased receivables governed by the laws of the USA and the related security?

The purchaser would be required to comply with the same formalities as did the seller, as provided in the answers to questions 4.2 and 4.3, although different locations of the purchaser and seller

may result in the laws of a different jurisdiction being applicable to questions of perfection. Generally, if the relevant security agreement permits the filing of an “all assets” financing statement, and the purchaser has appropriately filed such a statement, no additional UCC filing will be required in order for the providers of such purchaser’s funding to have a security interest in such receivables.

**5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of the USA, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in the USA or must additional steps be taken in the USA?**

Generally, yes.

**5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

See the answer to question 4.3.

**5.6 Trusts. Does the USA recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?**

Yes, trusts of various forms are generally recognised in United States jurisdictions; however, if the transaction is classified as a security interest under the UCC (as discussed above, this includes the purchase of most receivables) then simply having the seller agree to hold the assets in trust for the purchaser will not be sufficient to avoid the perfection and other requirements of the UCC.

**5.7 Bank Accounts. Does the USA recognise escrow accounts? Can security be taken over a bank account located in the USA? If so, what is the typical method? Would courts in the USA recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in the USA?**

Generally, jurisdictions in the United States will recognise escrow accounts, although the specific elements required for an escrow account and the specific legal status of an escrow account will vary by state. Generally, security can be taken over a deposit account in United States jurisdictions. Typically this is accomplished through an account control agreement whereby the depositary bank, the obligor and the secured party agree that the bank will follow the directions of the secured party rather than the account holder upon the occurrence of certain events. A court in the United States should recognise a foreign law grant of security taken over a bank account located in the United States as long as the form of security and perfection satisfied the requirement of control under the UCC, notwithstanding the law governing the instrument of control, subject to the choice of law, consideration addressed by the answers to the questions in section 2.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

A secured party with control over a deposit account would have control over all funds thereafter credited to the deposit account; however, any bankruptcy filing by the grantor of the security interest would cut off the secured party’s security interest as to funds credited to the account after the bankruptcy filing or within 90 days prior to the filing (one year if the secured party is an insider of the grantor).

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Yes, the owner could have such access.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will the USA’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

If the sale of receivables was a true sale that occurred prior to the commencement of the seller’s insolvency proceeding, then the receivables involved in such a sale would not constitute property of the seller’s bankruptcy estate. Accordingly, the automatic stay imposed by section 362 of the Bankruptcy Code would not prohibit the purchaser from exercising ownership rights over the purchased receivables. No insolvency official (such as a debtor-in-possession, bankruptcy trustee, creditors’ committee or bankruptcy court) would have the right to stay or otherwise affect the purchaser’s rights regarding the receivables while that insolvency official determines whether the sale was perfected. However, the insolvency official can allege during the insolvency proceeding that the sale in fact was a secured loan, rather than a true sale.

The answer would be different if the purchaser is deemed only to be a secured party, rather than the owner of the receivables. Specifically, if either (a) the transaction was, in fact, a secured loan, or (b) the purchaser was still required (as of the commencement of the seller’s insolvency proceeding) to take some action under the sale agreement *vis-à-vis* the seller before it was contractually entitled to collect the receivables, then the receivables would remain property of the seller’s bankruptcy estate. Accordingly, the automatic stay would prohibit actions by the purchaser to obtain possession of, or otherwise exercise control over, the receivables. The purchaser could file a motion with the bankruptcy court for relief from the automatic stay to allow it to collect or otherwise exercise control over the receivables. However, any party in interest in the insolvency proceeding could object to the motion, and the bankruptcy court could deny the motion.

**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

If the transaction was a true sale, then the insolvency official normally does not have the power to prohibit the purchaser from exercising its rights as to the receivables purchased. However, the insolvency official conceivably could still request that the bankruptcy court issue an injunction or stay order (particularly if there is a question about whether the transaction was a true sale or if there was an infirmity in the transaction), and the bankruptcy court would have discretion in determining whether or not to grant such a request. The bankruptcy court has some leeway to fashion equitable relief.

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in the USA for (a) transactions between unrelated parties, and (b) transactions between related parties?**

The debtor-in-possession, bankruptcy trustee or other party with requisite standing can avoid a transaction that took place within two years before the commencement of the insolvency proceeding, if the transaction was a fraudulent transfer pursuant to section 548 of the Bankruptcy Code. The look-back period for fraudulent transfers is two years both for transactions between unrelated parties and for transactions between related parties and, as discussed below, the look-back period for "preferences" is generally 90 days. Under section 548, a transaction constitutes a fraudulent transfer if the debtor (a) made a transfer or incurred an obligation with an actual intent to hinder, delay or defraud any entity to which the debtor was or became indebted, or (b) received less than a reasonably equivalent value in exchange for the transfer or obligation, and the debtor (i) was insolvent when the transfer was made or the obligation was incurred, or became insolvent as a result thereof, (ii) was engaged (or was about to engage) in a business or transaction for which any property remaining with the debtor was an unreasonably small capital, or (iii) intended to incur (or believed that it would incur) debts beyond its ability to pay as such debts matured. If a transaction is avoided as a fraudulent transfer, then a transferee that takes for value and in good faith would have a lien on, or may retain, any property the debtor transferred to it, but only to the extent that the transferee gave value to the debtor in exchange for the transfer.

Pursuant to section 544 of the Bankruptcy Code, the debtor-in-possession, bankruptcy trustee or other party with requisite standing can avoid a transaction under applicable non-bankruptcy law. For example, a transaction could be avoided under state fraudulent transfer law. Most state fraudulent transfer statutes are based on the Uniform Fraudulent Transfer Act, and others are based on the older Uniform Fraudulent Conveyance Act. These statutes contain elements that are similar to those set forth in section 548 of the Bankruptcy Code, though the look-back period under state fraudulent transfer statutes generally is longer than that under section 548. For example, the statute of limitations under the Uniform Fraudulent Transfer Act is four years after the transfer was made.

If the transaction is deemed to be a secured loan by the special purpose vehicle to the originator, then the debtor-in-possession,

bankruptcy trustee or other party with requisite standing can avoid transfers made by the debtor-originator in connection with the transaction as preferential transfers, pursuant to section 547 of the Bankruptcy Code. Preferential transfers are those made (a) to a creditor, (b) on account of an antecedent debt owed by the debtor before the transfer was made, (c) while the debtor was insolvent, and (d) that enable the creditor to receive more than it would have received in a chapter 7 (liquidation) case. Generally, only transfers made within 90 days before the commencement of the insolvency proceeding are subject to avoidance as preferential transfers. However, transfers made to a special purpose vehicle within one year before the commencement of the insolvency proceeding may be subject to avoidance, because such transfers may be deemed to have been made to an "insider" (*i.e.*, a related party). Courts typically recognise payments to fully-secured creditors as not being preferential. Even if the plaintiff can establish all of the elements of a preference claim, there are a number of statutory affirmative defences available to creditors, including defences for transfers made in the ordinary course of business and transfers in which the creditors provided contemporaneous or subsequent new value to the debtor.

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

Courts have the equitable power to order substantive consolidation under section 105(a) of the Bankruptcy Code. Substantive consolidation has the effect of consolidating the assets and liabilities of multiple legal entities and treating them as if the liabilities were owed by, and the assets held by, a single legal entity. Inter-company claims and guarantees by consolidated entities are disregarded. Substantive consolidation may be ordered with respect to related entities that are all the subject of an insolvency proceeding, and also may be ordered with respect to related entities where some are the subject of an insolvency proceeding and the others are not.

Courts in the United States do not apply a uniform standard in determining whether to order substantive consolidation. However, a number of influential courts have stated that substantive consolidation is an extraordinary remedy that typically is reserved for circumstances in which (a) creditors had dealt with the various legal entities as a single economic unit and did not rely on their separate identity in extending credit or (b) the affairs of the entities were so entangled that substantive consolidation would benefit creditors. Courts are more likely to order substantive consolidation when principal parties consent.

In the past, courts have relied on a consideration of the following factors (among others) to guide their analysis of whether the relationships between multiple legal entities are so obscured that they could not be disentangled:

- (1) the presence or absence of consolidated financial statements;
- (2) the unity of interests and ownership between various corporate entities;
- (3) the existence of parent and inter-corporate guarantees on loans;
- (4) the degree of difficulty in segregating and ascertaining individual assets and liabilities;
- (5) the transfer of assets without observance of corporate formalities;
- (6) the commingling of assets and business functions; and



(7) the profitability of consolidation at a single physical location. Recent court decisions have adopted an open-ended, equitable inquiry to determine whether to substantively consolidate multiple legal entities. These courts have focused on the need in insolvency proceedings to protect the pre-petition expectations of creditors. Both case law and policy considerations indicate that a court primarily should base its determination on whether or not substantive consolidation would be equitable to the respective creditors of the entities for which substantive consolidation is sought.

When a special purpose vehicle is used as part of a securitisation transaction, parties rely on the separate corporate existence of that special purpose vehicle. The special purpose vehicle should be monitored to ensure that (a) corporate formalities are observed, (b) the assets and liabilities of the special purpose vehicle can be readily distinguished from those of the originator, (c) the separate legal existence of the special purpose vehicle and the originator are disclosed to third parties, and (d) the special purpose vehicle is appropriately limited in its investments, indebtedness, business and ownership. If this is the case and the originator were to become a debtor in an insolvency proceeding, then it is unlikely that a court would order substantive consolidation of the originator and the special purpose vehicle if a party objects.

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in the USA, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

The commencement of an insolvency proceeding of the originator would create uncertainties as to sales of receivables that have not yet occurred and sales of receivables that have not yet come into existence.

First, many future flow securitisations are structured such that there is recourse back to the originator (which may take the form of a guarantee from the originator). The existence of such recourse could cause a court to conclude that the future flow securitisation was not a true sale, but rather, was a secured loan.

Second, the receivables generated after the commencement of the originator's insolvency proceeding could be deemed to be included in the originator's bankruptcy estate, thus triggering the automatic stay as to those receivables. In addition, receivables generated after the commencement of the originator's insolvency proceeding generally would not be subject to a lien resulting from the security agreement entered into by the originator and the special purpose vehicle before the bankruptcy filing (unless such receivables are the proceeds, products, offspring or profits of assets acquired prior to the bankruptcy filing and subject to a security agreement).

Third, if the assets securitised are receivables that arise under executory contracts, there is a risk that in an insolvency proceeding involving a party to the contract, that party would "reject" the executory contract and no further receivables would be generated. The term "executory contract" is not defined in the Bankruptcy Code, but numerous courts have described it as a contract under which the obligations of both the debtor and the non-debtor are so far unperformed that the failure of either party to complete performance would constitute a material breach that excuses the performance of the other party. A debtor's decision to reject an executory contract is subject to bankruptcy court approval, and parties have an opportunity to object to a proposed rejection.

However, bankruptcy courts generally will approve the rejection of executory contracts so long as the debtor demonstrates a valid business justification for its decision to reject. The rejection of an executory contract is treated as a court-authorised breach by the debtor, and gives rise only to an unsecured claim by the non-debtor party for damages.

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

Generally, no. However, some courts in certain United States jurisdictions may find that a debtor is insolvent on the grounds that it cannot pay its debts as they come due notwithstanding limited recourse provisions in the debtor's contracts. Such a finding of insolvency may be used to trigger springing recourse liability, which may allow lenders to pursue the assets of the debtor and/or certain guarantors pursuant to applicable "bad boy" provisions in the underlying loan documents.

## 7 Special Rules

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in the USA establishing a legal framework for securitisation transactions? If so, what are the basics?**

Not as such.

**7.2 Securitisation Entities. Does the USA have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

Not as such. Certain U.S. federal tax laws, investment company regulations and securities laws have some provisions that facilitate securitisation by providing special rules for special purpose entities that satisfy certain requirements. Most domestic securitisations in the United States use entities organised as corporations, limited liability companies or statutory trusts under the laws of Delaware. Trusts created under the laws of New York are also common. Some types of U.S. securitisations, such as CDOs, use entities domiciled in offshore jurisdictions such as the Cayman Islands.

**7.3 Limited-Recourse Clause. Will a court in the USA give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

Courts in New York, if New York law is validly selected, typically will enforce limited-recourse clauses and any carve-outs thereto. These courts will determine, based on the facts of each case, whether any of the carve-outs to the limited-recourse clause apply in a particular situation. In interpreting the limited-recourse provision and its carve-outs, courts will analyse their language in an attempt to determine the intent of the parties. Courts will enforce the agreement of the parties, giving the contract language its normal

and usual meaning. If a court determines that a carve-out to the limited-recourse clause applies in a particular case, then recourse may not be limited. Courts generally will give effect to a limited-recourse provision in a contract where the governing law is that of another country, unless the enforcement of that provision would offend the public policy of the state in which the court convenes as set forth in question 2.3.

Under section 1111(b) of the Bankruptcy Code, however, the general rule is that a secured claim in a Chapter 11 case is treated as a recourse claim, whether or not it is limited-recourse by agreement or applicable law. This section of the Bankruptcy Code converts limited-recourse claims to recourse claims, but also permits classes of undersecured creditors to elect to waive their deficiency claims and have their entire allowed claims treated as secured claims. This provision does not apply if the property is to be sold.

---

**7.4 Non-Petition Clause. Will a court in the USA give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

---

“Covenants not to sue” typically are governed by state law, and courts will interpret them in accordance with the rules governing the construction of contracts. To be enforceable, a covenant not to sue should be supported by adequate consideration by the beneficiary of the covenant. Courts very rarely refuse to enforce covenants not to sue that are negotiated in business transactions. However, they will not enforce covenants not to sue that violate applicable law or public policy.

Courts typically will also enforce contractual provisions prohibiting parties from commencing an involuntary insolvency proceeding against a purchaser or another person. Like covenants not to sue, courts will interpret these provisions in accordance with the rules governing the construction of contracts, and they should be supported by adequate consideration. However, covenants preventing entities from filing voluntary bankruptcy petitions probably are unenforceable.

---

**7.5 Priority of Payments “Waterfall”. Will a court in the USA give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

---

In general, sophisticated parties may allocate proceeds of collateral and other payments among themselves by contract. Whether a US court would apply a foreign choice of law depends on a wide range of factors but in general such choice of law is likely to be upheld if the jurisdiction chosen has a substantial relationship to the transaction and the application of such foreign law is not contrary to any fundamental policy of the applicable U.S. jurisdiction.

---

**7.6 Independent Director. Will a court in the USA give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

---

Independent directors are often found in U.S. securitisation

transactions in order to limit the ability of the SPE to commence voluntary bankruptcy proceedings. However, an agreement by an entity not to file a voluntary bankruptcy petition may be unenforceable as against public policy. In fact, failure of a director to commence bankruptcy proceedings when he/she properly concludes that it would be in the best interest of the SPE to do so may constitute a breach of fiduciary duty.

---

## 8 Regulatory Issues

---

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in the USA, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in the USA? Does the answer to the preceding question change if the purchaser does business with other sellers in the USA?**

---

Receivables purchases generally do not subject a purchaser to licensing or other qualification requirements to do business in the United States, although there may be exceptions to this rule from state to state depending upon the type of receivable. Collection and enforcement activities are more likely to require an entity to obtain a licence and qualify to do business within a state especially in the case of consumer receivables.

---

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

---

No general servicing licence is required. However, a servicer or replacement servicer may require the same licences possessed by the originator operating company depending upon the type of receivables and the jurisdiction involved. In addition, a servicer may need to meet certain licensing and other requirements with respect to collection and enforcement activities in limited instances.

---

**8.3 Data Protection. Does the USA have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

---

Confidential consumer information cannot generally be disclosed to third parties and can only be used for the purposes for which such information was provided. Entities possessing consumer information are generally obligated to safeguard such information from unauthorised access and disclosure.

---

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of the USA? Briefly, what is required?**

---

Consumer protection laws exist at both the federal and state levels in the United States. A purchaser may be liable for the acts of the seller originating the receivable, as these liabilities are considered to pass to the holder of the receivable. In addition, a purchaser could be subject to debt collection laws, reporting laws and confidentiality laws, among other laws.

**8.5 Currency Restrictions. Does the USA have laws restricting the exchange of the USA's currency for other currencies or the making of payments in the USA's currency to persons outside the country?**

Federal anti-money laundering laws require financial institutions to implement due diligence procedures with respect to their customers in order to prevent the transfer of cash to certain prohibited persons.

## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in the USA? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?**

The following summary assumes that the sale of the receivables by the seller to the purchaser will be respected as a true sale for U.S. federal income tax purposes whereby the seller will not retain any interest in the receivables. Payments of interest on any interest-bearing receivables with maturities in excess of 183 days to the seller or the purchaser by obligors who are United States persons (hereinafter, "U.S. source interest") generally are subject to U.S. federal withholding tax if the seller or the purchaser is a non-resident of the United States. The statutory rate of U.S. federal withholding tax generally is 30 percent, but this rate can be reduced to 0 percent (or other lower rate) by an applicable income tax convention between the United States and the seller's or purchaser's country of residence. In addition, certain payments of U.S. source interest are exempt from U.S. federal withholding tax under the "portfolio interest" exception to withholding but most receivables are not in the registered form necessary to meet this exception. In addition, beginning on 1 July 2014, such U.S. source interest payments generally will be subject to a 30 percent withholding tax under FATCA if paid to a "foreign financial institution" or a "non-financial foreign entity", unless (i) the foreign financial institution undertakes certain diligence and reporting obligations, (ii) the non-financial foreign entity either certifies it does not have any "substantial United States owners" or furnishes identifying information regarding each substantial United States owner, or (iii) the foreign financial institution or non-financial foreign entity otherwise qualifies for an exemption from these rules. Entities located in jurisdictions that have an intergovernmental agreement with the United States governing FATCA may be subject to different rules. Furthermore, payments of U.S. source interest to the seller or the purchaser may also be subject to "backup withholding" if the seller or the purchaser does not provide the payer with the appropriate certification that it is exempt from backup withholding. Backup withholding currently is imposed at a rate of 28 percent. It is not an additional tax but rather an advance payment of tax which may later be credited or refunded. Payments of interest to the seller or the purchaser by an obligor who is not a United States person generally is not subject to U.S. federal withholding tax unless such interest arises from a branch in the United States maintained by such obligor. Depending on the

particular facts, a purchase of a trade receivable at a discount could cause the discount to be treated as market discount to the purchaser for U.S. federal income tax purposes. Market discount accrued on a receivable held by a purchaser that is a non-resident of the United States will generally not be subject to U.S. federal withholding tax. Depending on the particular facts, a sale of a trade receivable where a portion of the purchase price is payable upon collection of the receivable could cause a portion of the purchase price to be recharacterised as interest income to the seller for U.S. federal income tax purposes. If so, U.S. federal withholding tax may apply to such interest if the buyer is a resident of the United States and the seller is not, in the absence of an applicable exemption.

**9.2 Seller Tax Accounting. Does the USA require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

Most taxpayers are required to use the accrual method of accounting. In certain limited cases, some securitisation vehicles may elect to mark their assets to market.

**9.3 Stamp Duty, etc. Does the USA impose stamp duty or other documentary taxes on sales of receivables?**

There are no federal stamp duties or documentary taxes on sales of receivables, and these types of charges are unusual at the state level.

**9.4 Value Added Taxes. Does the USA impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

There are no federal value added taxes or sales taxes on sales of goods or services, on sales of receivables or on fees for collection agent services. Virtually all of the 50 states of the United States have some form of state sales tax on sales of goods or services. In general, no value added, sales or similar taxes will apply to sales of receivables or to fees for collection agent services.

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

As discussed above, there are no federal stamp duties or documentary taxes on sales of receivables. The ability of state taxing authorities to collect any value added tax, stamp duty or other taxes, if imposed, may vary.

**9.6 Doing Business. Assuming that the purchaser conducts no other business in the USA, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in the USA?**

If a non-resident purchaser is considered to be carrying on a trade or business in the United States, it will be required to file a U.S. federal income tax return and, absent an applicable income tax convention between the United States and the country where the

non-resident purchaser is resident, will be required to pay United States federal income tax on any income that is effectively connected with its carrying on of a trade or business in the United States (ECT). Typically, a purchaser resident in a country with which the United States has an income tax convention will only be subject to U.S. federal income tax on its ECT from a trade or business carried on through a permanent establishment in the United States.

Whether or not the purchaser is carrying on a business in the United States, or has a permanent establishment in the United States, is a question of fact to be considered on a case-by-case basis. Particular attention must be given to the appointment of a seller resident in the United States as servicer and collection agent for a non-resident purchaser, in order that such appointment does not cause the purchaser to be considered to be carrying on a trade or business through a permanent establishment in the United States (thus giving rise to ECT).



#### Lawrence Safran

Latham & Watkins LLP  
885 Third Avenue  
New York, NY 10022-4834  
USA

Tel: +1 212 906 1711  
Fax: +1 212 751 4864  
Email: [larry.safran@lw.com](mailto:larry.safran@lw.com)  
URL: [www.lw.com](http://www.lw.com)

Lawrence Safran leads the firm's Uniform Commercial Code practice. This area includes a wide variety of commercial law issues. Special emphasis is placed on those issues arising under Article 9 (secured transactions) and Article 8 (investment securities) of the Uniform Commercial Code although the practice also includes Article 2 (sales of goods), Article 3 (negotiable instruments), Article 5 (letters of credit), Article 6 (bulk sales) and Article 7 (documents of title).

Mr. Safran has advised clients on commercial law and personal property transfer issues in connection with credit facilities, secured bond transactions, project financings, real estate securitisations, collateralised debt obligations, credit card and other receivables financings and other structured financing arrangements.



#### Kevin T. Fingeret

Latham & Watkins LLP  
885 Third Avenue  
New York, NY 10022-4834  
USA

Tel: +1 212 906 1237  
Fax: +1 212 751 4864  
Email: [kevin.fingeret@lw.com](mailto:kevin.fingeret@lw.com)  
URL: [www.lw.com](http://www.lw.com)

Kevin Fingeret is a partner in the New York office of Latham & Watkins. Mr. Fingeret is a member of the Finance department and is the global Co-chair of the Structured Finance and Securitization Practice. Mr. Fingeret is also a member of the firm's Aircraft Finance Practice.

Mr. Fingeret has extensive experience representing banks and other financial institutions, issuers, borrowers and sponsors in a wide variety of structured finance and securitisation transactions and aircraft finance transactions.

Mr. Fingeret specialises in the securitisation of esoteric and operating assets. His experience includes aircraft portfolio securitisations, EETC aircraft financings and securitisations of rental car fleets, wireless cell towers (and related real property interests), broadcast towers, billboards, equipment leases and music royalties. Mr. Fingeret also has substantial experience with traditional ABS, such as auto loan and credit card securitisations and traditional aircraft finance, such as bank financings and sale-leaseback transactions involving aircraft, engines and spare parts.

Mr. Fingeret also has over fourteen years of experience representing issuers, underwriters and managers in CLO transactions.

## LATHAM & WATKINS LLP

Latham & Watkins is a global law firm with approximately 2,100 lawyers in its offices located in Asia, Europe, the Middle East and the United States, including: Abu Dhabi, Barcelona, Beijing, Boston, Brussels, Chicago, Doha, Dubai, Düsseldorf, Frankfurt, Hamburg, Hong Kong, Houston, London, Los Angeles, Madrid, Milan, Moscow, Munich, New Jersey, New York, Orange County, Paris, Riyadh, Rome, San Diego, San Francisco, Shanghai, Silicon Valley, Singapore, Tokyo and Washington, D.C. For more information on Latham & Watkins, please visit the website at [www.lw.com](http://www.lw.com).



## Other titles in the ICLG series include:

- Alternative Investment Funds
- Aviation Law
- Business Crime
- Cartels & Leniency
- Class & Group Actions
- Competition Litigation
- Construction & Engineering Law
- Copyright
- Corporate Governance
- Corporate Immigration
- Corporate Recovery & Insolvency
- Corporate Tax
- Data Protection
- Employment & Labour Law
- Environment & Climate Change Law
- Franchise
- Insurance & Reinsurance
- International Arbitration
- Lending & Secured Finance
- Litigation & Dispute Resolution
- Merger Control
- Mergers & Acquisitions
- Mining Law
- Oil & Gas Regulation
- Patents
- Pharmaceutical Advertising
- Private Client
- Product Liability
- Project Finance
- Public Procurement
- Real Estate
- Shipping Law
- Telecoms, Media & Internet
- Trade Marks



59 Tanner Street, London SE1 3PL, United Kingdom  
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255  
Email: [sales@glgroup.co.uk](mailto:sales@glgroup.co.uk)

[www.iclg.co.uk](http://www.iclg.co.uk)