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**FUNDAMENTALS OF FINANCIAL MARKETS**  
HONG KONG | FRIDAY, 6 SEPTEMBER 2024

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**SECURED LENDING**

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# SECURED LENDING

## INTRODUCTION



### What is Security?

- Rights *in personam* (claims against persons)
- Rights *in rem* (interests in property)

### Why Take Security?

- Credit enhancement
- Protection/defence: *pari passu*
- Regulatory

# SECURED LENDING

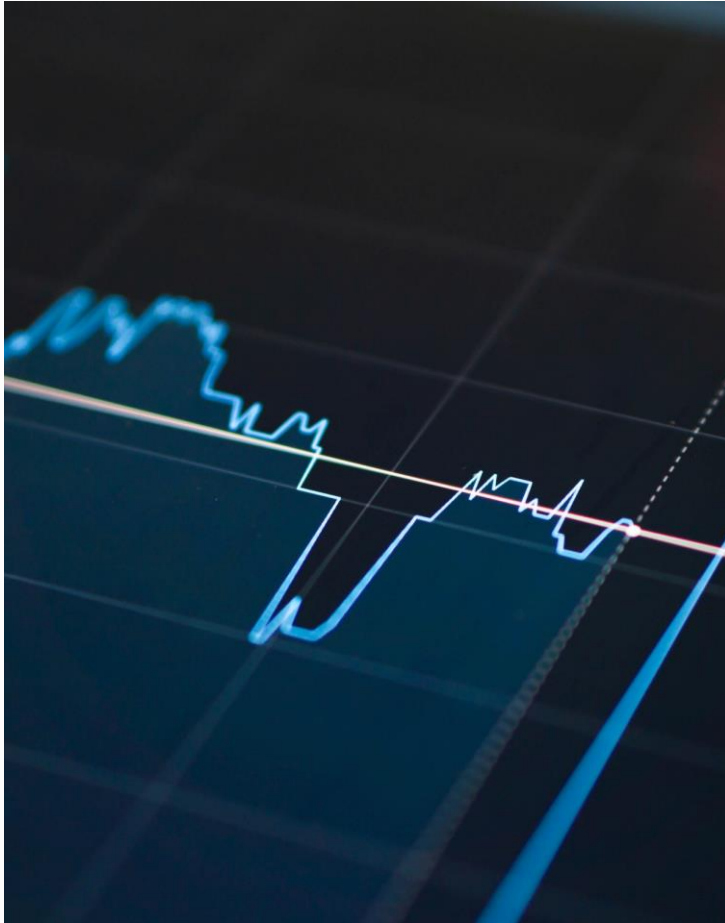
## WHY TAKE SECURITY?

Debt	Lender A: US\$40m Lender B: US\$40m Lender C: US\$20m Total: US\$100m
Available assets	Various landed properties worth US\$60m
All lenders are unsecured	Lender A: US\$24m Lender B: US\$24m Lender C: US\$12m
Lender A is secured on a property worth US\$40m and the other lenders are unsecured	Lender A: US\$40m Lender B: US\$13.33m Lender C: US\$6.67m

- Priority
- Ability to raise future debts
- Negative pledge

# SECURED LENDING

## TYPES OF SECURITY



### Possessory:

#### Lien

- Borrower delivers possession
- Arise by operation of law
- No power of sale.

#### Pledge

- Borrower delivers possession but retains legal ownership
- Power of sale.

# SECURED LENDING

## TYPES OF SECURITY (CONTINUED)



### Non-possessory

#### Mortgage

- Transfer of title
- Power of sale
- Equity of redemption

#### Charge

- No transfer of title – an encumbrance with a power of sale
- Fixed charge (e.g. limited right to deal with the security asset)
- Floating charge (e.g. right to deal with the security asset until a crystallisation event such as EOD)
- Priority of fixed vs floating charge

# SECURED LENDING

## TYPES OF SECURITY (CONTINUED)



### Non-possessory (continued)

#### Assignment by Way of Security/Security Assignment

- For chose in action
- Essentially a mortgage
- Notification/acknowledgement requirements

# SECURED LENDING

## TYPES OF SECURITY (CONTINUED)

### Key Assets

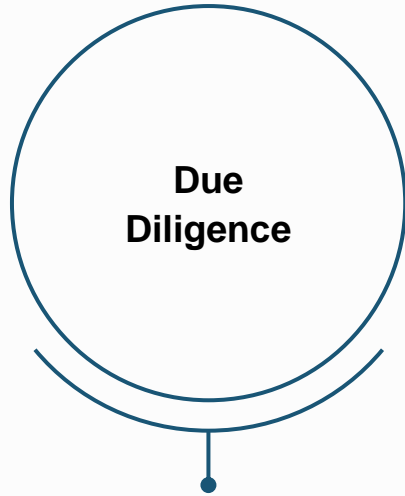
Shares	Contracts/Book Debts	Bank Accounts	Land
<ul style="list-style-type: none"><li>• Charge</li><li>• Mortgage?</li><li>• Pledge?</li></ul>	<ul style="list-style-type: none"><li>• Security assignment</li><li>• Charge</li></ul>	<ul style="list-style-type: none"><li>• Security assignment</li><li>• Charge</li></ul>	<ul style="list-style-type: none"><li>• Mortgage?</li><li>• Charge</li></ul>

All-asset security: Debenture

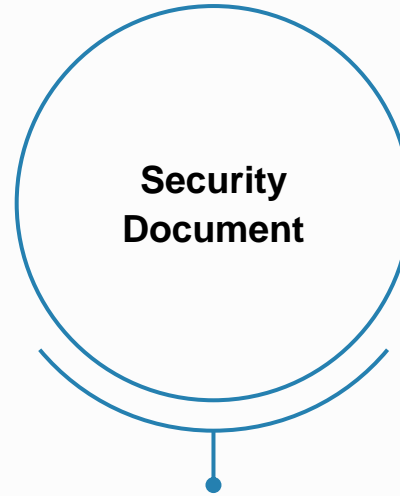


# SECURED LENDING

## HOW TO TAKE SECURITY?



- Title and priority
- Value: DD reports, valuation report
- Restrictions on security and enforcement
- Financial conditions of security provider.

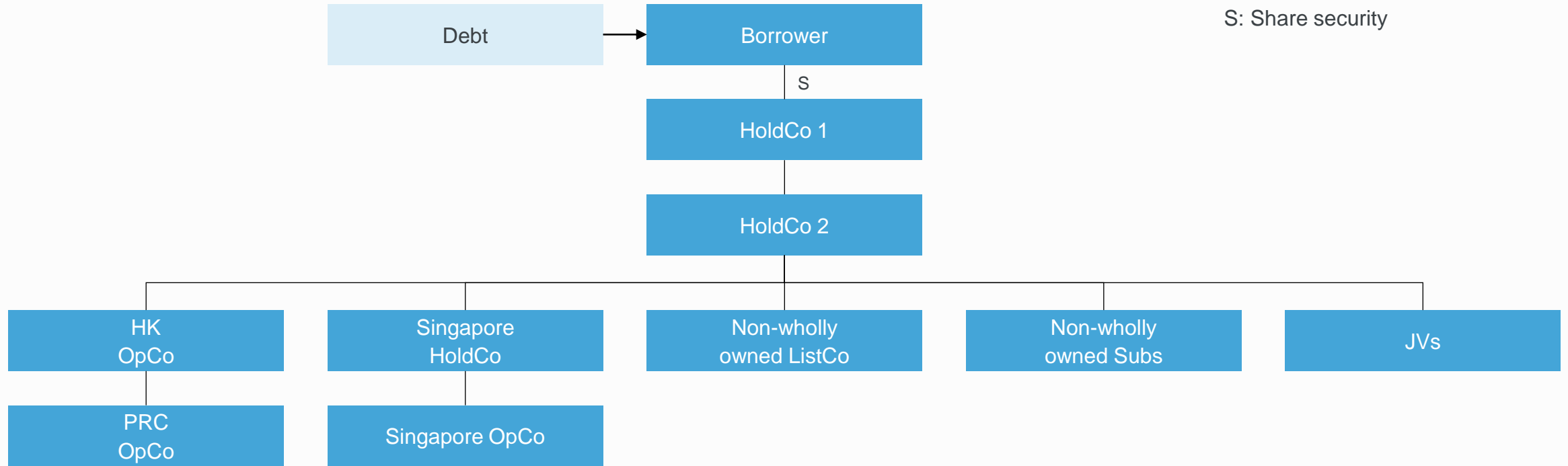


- Law
- Form of security
- Corporate authorisation
- Execution formality (e.g., execution before a notary)
- Language
- Tax
- Ancillary documents (e.g., documents which facilitate enforcement).

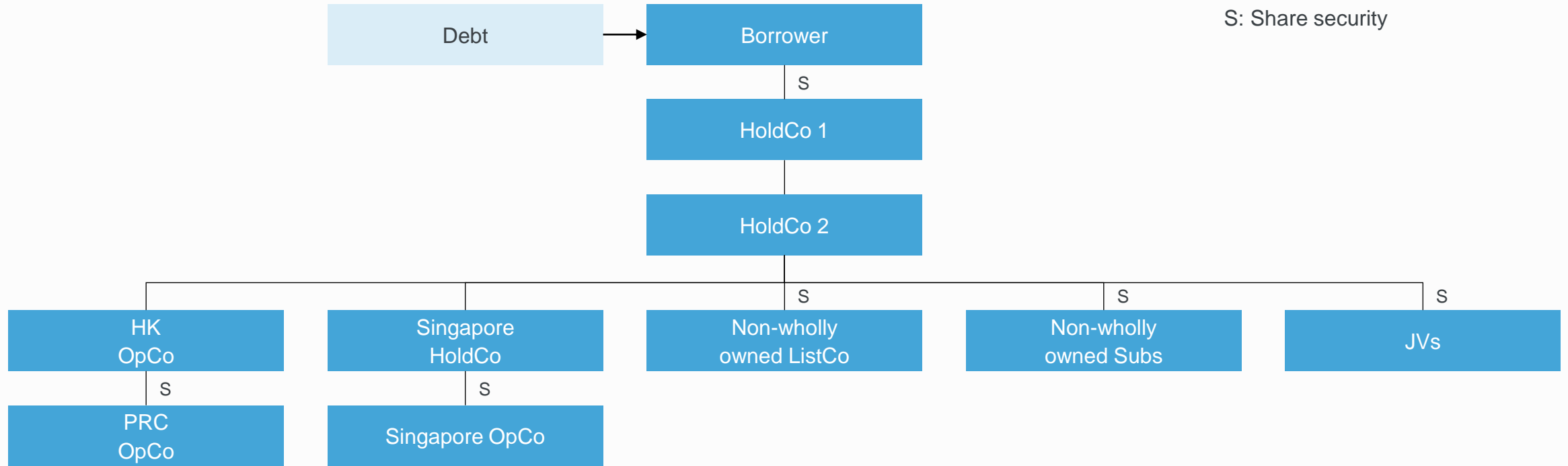


- Possession
- Registration (e.g., HKCR registration if the chargor is a HK company, State Administration for Market Regulation (SAMR) registration, land registration)
- Notice (e.g., security assignment).

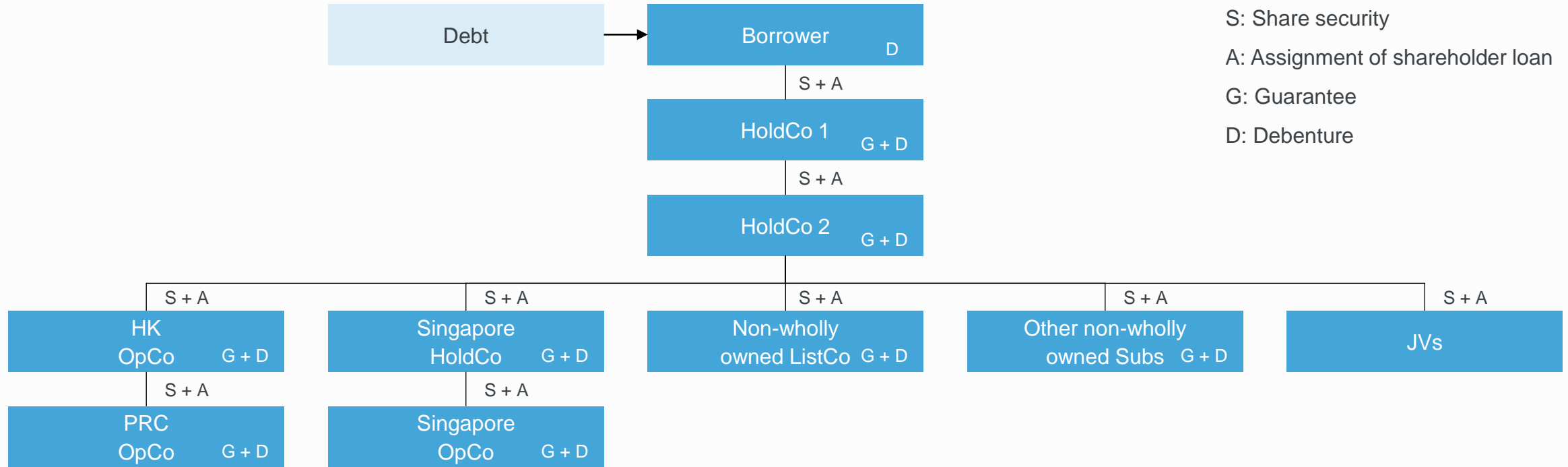
# SECURED LENDING STRUCTURE



# SECURED LENDING STRUCTURE (CONTINUED)

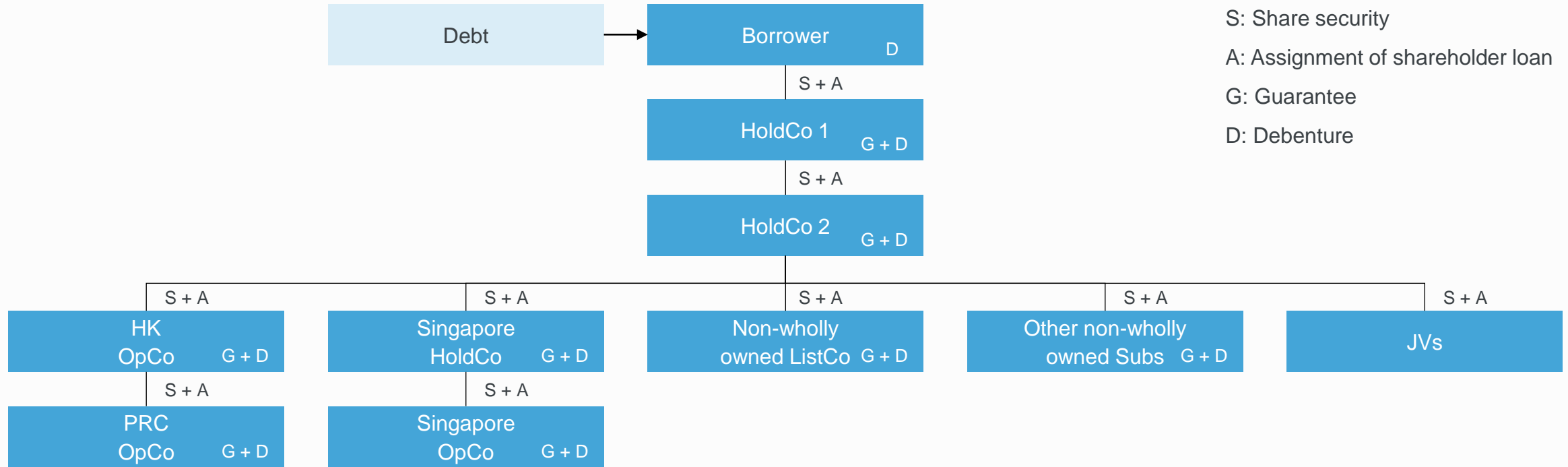


# SECURED LENDING STRUCTURE (CONTINUED)



# SECURED LENDING

## COMMON ISSUES AND CONSIDERATION

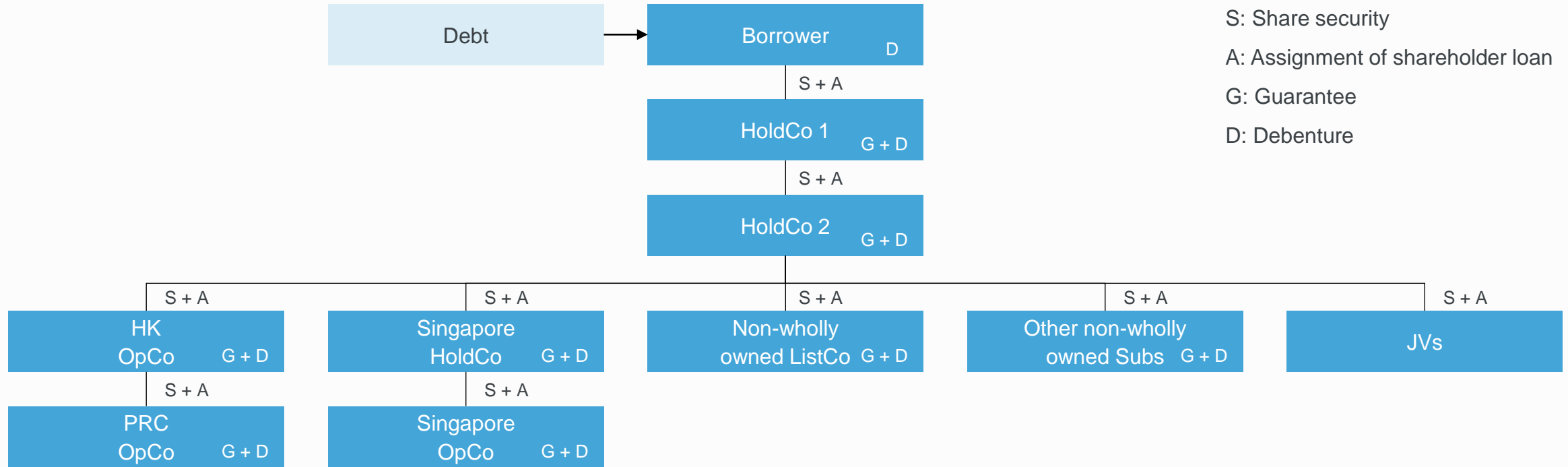


### Feasibility:

- Legal feasibility (e.g. availability of all-assets debenture, restriction on ownership, financial assistance)
- Listing rules requirements (e.g. EGM, DOI)
- Contractual restriction (e.g. restriction on assignment in contracts, restriction on transfers in shareholders agreement and articles)
- Corporate authorisation
- Cost/benefit analysis.

# SECURED LENDING

## COMMON ISSUES AND CONSIDERATION (CONTINUED)



S: Share security  
 A: Assignment of shareholder loan  
 G: Guarantee  
 D: Debenture

### Enforcement and value:

- Restriction on ownership
- Presence of minority interest and rights: pre-emptive rights, tag-along rights, minority veto rights, director appointment, passage of special rights, etc.
- Restriction on transfer
- Remittance issue.

# SECURED LENDING

## COMMON ISSUES AND CONSIDERATION (CONTINUED)



**Preservation of  
Value in the Case  
of Share Security**

- Restriction on incurrence of debt
- Restriction on disposals
- Restriction on acquisitions and investment
- Restriction on issuance of shares
- Restrictions on loans and guarantees
- Arm's length requirement
- Negative pledge
- Restriction on mergers
- Restriction on dividends.

# SECURED LENDING

## COMMON ISSUES AND CONSIDERATION (CONTINUED)



How Can Security  
Be Defective/  
Attacked?

- Breach of contract
- Title/priority
- Documentary requirements
- Power/authority
- Defective perfection
- Insolvency (winding-up/bankruptcy): clawback period
- Challenges from minority shareholders/creditors
- Enforcement process



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