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Hong Kong
Securitisation

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This country-specific Q&A provides an overview of securitisation laws and regulations applicable in Hong Kong.

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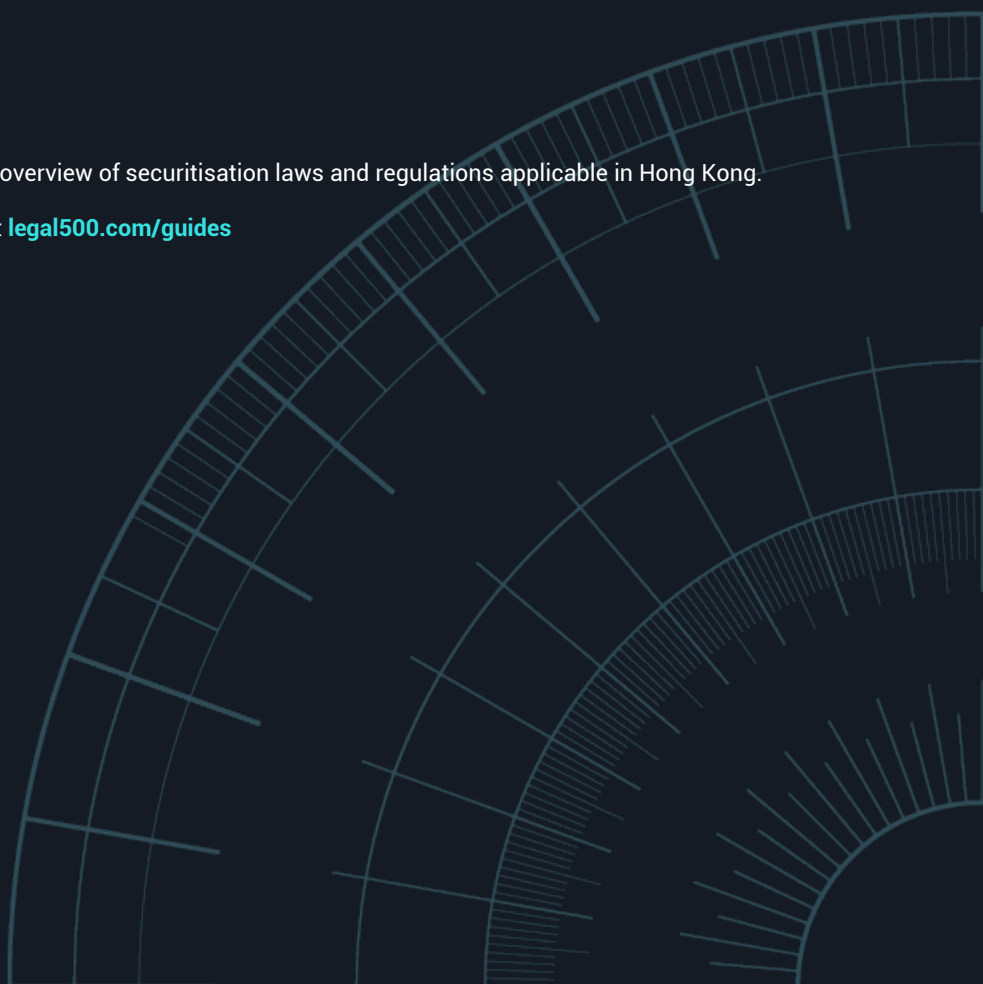

Hong Kong: Securitisation

1. How active is the securitisation market in your jurisdiction? What types of securitisations are typical in terms of underlying assets and receivables?

Market Overview:

The securitisation market in Hong Kong remains relatively active, though not as large as markets in the United States or Europe. Historically, Hong Kong has seen periodic activity in securitisation transactions, particularly for mortgage-backed securities (MBS), asset-backed securities (ABS), and collateralised loan obligations (CLOs).

In recent years, securitisation activity has increased, driven by:

- The demand for alternative funding sources amid high-interest rate volatility.
- Increased use of structured finance solutions by financial institutions, corporations, and fintech companies as alternative funding sources.
- Regulatory developments that support capital efficiency for banks under Basel III requirements.
- The growing interest in green and ESG-linked securitisations.

While Hong Kong's securitisation market is not as large in terms of total issuance amounts as those of the US, UK or Europe, Hong Kong's role as an international financial center with a favorable tax and regulatory regime still makes it a preferred jurisdiction for structuring cross-border securitisations involving assets originated in Mainland China and other parts of Asia.

Types of Securitisations and Underlying Assets:

Hong Kong has an active and established securitisation market that has evolved through many decades of development. Today, a broad variety of receivables types can be securitised. These include trade receivables, consumer debt receivables, commercial loan receivables, various types of debt securities and mortgage loan receivables. According to a recent survey of the Hong Kong Monetary Authority ("**HKMA**"), securitisation products in Hong Kong include asset-backed securities, mortgage-backed securities, collateralised debt obligations, notes issued by structured investment vehicles, asset-backed commercial papers, and other similar structured credit products.

In recent years, the HKMA has been promoting infrastructure securitisation to provide a financing platform to facilitate infrastructure investments. Insurance-linked securitisations (ILS) and ESG-linked securitisations have also gained attention, particularly with Hong Kong's push to be an international hub of green finance and ILS instruments.

The most common form of securitisation in Hong Kong involves the issuance of asset-backed securities ("**ABS**") in the private investment market to professional investors. ABS issued solely to professional investors may not be subject to the full spectrum of public disclosure requirements. These offerings are generally less regulated but must still comply with basic conduct rules and provide certain disclosures.

2. What assets can be securitised (and are there assets which are prohibited from being securitised)?

In Hong Kong, securitisation structures are generally flexible, allowing a broad range of financial assets to be securitised. The key criteria for a securitisable asset are its ability to generate predictable and stable cash flows that can be packaged into securities for investors. Any contractual (or in some cases statutory) right to payment, including contingent or future receivables (a contract to transfer future receivables when they come into existence is enforceable under the laws of equity), is capable of being securitised in Hong Kong.

Types of receivables which have been securitised include trade receivables, corporate loan receivables, project loan receivables, consumer loan receivables and property mortgages (residential and commercial). More complex or structured products, such as collateral debt obligations, which derive cash flow from a pool of bonds or other assets and pays investors based on the seniority of the tranches the investor holds, have also been structured in Hong Kong.

There are no specific categories of receivables which are, in and of themselves, prohibited from being securitised. However, some assignment of receivables may give rise

to additional considerations, for example:

a. a contractual term of the receivables purports to prohibit their assignment;
b. traditional bank deposits and certain retail investment products (e.g., unit trusts and mutual funds) are not typically securitisable;
c. there are public policy grounds (for instance, assignments of salary payments);
d. the originator is a public authority or government (which may not be able to transfer its assets depending on the asset type);
e. government bonds may be securitised in structured forms, but direct securitisation of public-sector receivables may require legislative approval or compliance with relevant local regulations.
f. certain types of consumer debt, particularly those subject to unfair lending practices, may face restrictions under Hong Kong's regulatory framework;
g. illegal assets or securitisation that may contravene any applicable national security laws; or
h. certain receivables can only be transferred to purchasers holding a particular licence, for example, receivables related to a business or activity regulated under the Money Lenders Ordinance (Cap. 163), the Banking Ordinance (Cap. 155) or the Securities and Futures Ordinance (Cap. 571).

Separately, the Insurance Ordinance (Cap. 41) was amended on 29 March 2021 to regulate the issuance of insurance-linked securities ("**ILS**") in Hong Kong, whilst the Insurance (Special Purpose Business) Rules (Cap. 41P) restrict the sale of ILS only to certain eligible investors (including governments, insurance companies, banks, and regulated investment services corporations) with a minimum investment size of US$250,000. These restrictions on offering ILS also apply to repackaged products backed by ILS issued in Hong Kong.

3. What legislation governs securitisation in your jurisdiction? Which types of transactions fall within the scope of this legislation?

There are no legislations in Hong Kong that are specifically enacted to accommodate only securitisation transactions. However, the legal and regulatory framework in Hong Kong is well-developed and it provides a robust legal environment for securitisation transactions to be undertaken.

The following Hong Kong legislations and regulations may be relevant depending on the nature of the transaction and ought to be considered in securitisation transactions, as appropriate:

a. Banking Ordinance (Cap. 155) and the Code of Banking Practice, regulating various dealings of "authorised institutions" ("**AIs**") (as defined in the Banking Ordinance (Cap. 155);
b. Banking (Capital) Rules (Cap. 155L) on capital treatment and Banking (Disclosure) Rules (Cap. 155M) on related disclosure requirements applicable to AIs having securitisation exposures;
c. Banking (Exposure Limits) Rules (Cap. 155S) regulating the capital treatment for ABS held by banks, including requiring financial institutions to hold a certain amount of capital to cover risk exposure. The risk retention rule, which mandates that originators retain a portion of the securitised assets, is also reflected in HKMA guidance to ensure banks (when acting as originators) maintain sufficient skin in the game;
d. HKMA's Supervisory Policy Manual CR-G-12 providing guidance to AIs engaged in credit risk transfer activities (including securitisation transactions) whether acting as purchasers, originators or investors;
e. Companies Ordinance (Cap. 622) ("**Companies Ordinance**") in connection with corporate originators and the registration of security;
f. Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) ("**CWUMPO**") in connection with insolvency, and authorisation and registration of offering documentation for the offers of debentures to the public in Hong Kong and the related exemptions;
g. Conveyancing and Property Ordinance (Cap. 219) ("**CPO**") in connection with insolvency and claw-back or avoidance of certain transfers of property;
h. Securities and Futures Ordinance (Cap. 571) ("**SFO**") in connection with licensing and authorization of intermediaries dealing with ABS, and authorisation of public offering documentation of structured products and the related exemptions;
i. Subsidiary legislations and the various guidelines and circulars issued by the Securities and Futures Commission ("**SFC**"), in connection with the licensing and regulation of financial intermediaries engaged in "regulated activities" (eg, dealings in or advising on securities) (as defined in the SFO);
j. Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("**Code of Conduct**") governing conducts and obligations of financial intermediaries, with recent new rules governing intermediaries engaged in book-building or placing activities in debt capital market transactions (effective from 5 August 2022), covering certain book-running and placing activities in Hong Kong securitisation transactions;

k. Money Lenders Ordinance (Cap. 163) in connection with lending activity;
l. Law Amendment and Reform (Consolidation) Ordinance (Cap. 23) in connection with transfer of loans and receivables;
m. If an ABS relies on a credit rating, the issuer must ensure that the rating is issued by an agency that meets SFC standards and adheres to best practice guidelines to avoid misleading investors;
n. Personal Data (Privacy) Ordinance (Cap. 486) ("**PDPO**") in connection with the collection, use and transfer of personal data;
o. Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights – Banking Sector) Rules (Cap. 628) ("**Stay Rules**") requiring a mandatory provision on suspension of termination rights in foreign law governed covered contracts involving local AIs; and
p. The Hong Kong Stock Exchange's Listing Rules ("**Listing Rules**") governing the listing of debt securities either issued to retail investors in a public offering or to professional investors only.
q. The Inland Revenue (Amendment) (Taxation on Specified Foreign-sourced Income) Ordinance 2022, and the Inland Revenue (Amendment) (Taxation on Foreign-sourced Disposal Gains) Bill 2023 (the Bill) (together the "**Foreign-sourced Income Exemption**" or **FSIE**" regime), offering tax exemptions to deals involving foreign-sourced income or assets, providing incentives for structuring cross-border securitisation.

4. Give a brief overview of the typical legal structures used in your jurisdiction for securitisations and key parties involved.

Special Purpose Vehicles ("**SPV**") are typically used in securitisation transactions in Hong Kong. An SPV acts as the beneficial owner of the assets transferred from the originator and the issuer of the asset-backed notes, to insulate the assets from the financial and credit risks of the originator.

Key parties involved in securitisation transactions typically include:

a. **Issuer**: the issuer is often an orphan SPV with a restricted scope of business permitted to be undertaken.
b. **Sponsors**: A sponsor is often referred to as an "originator" in securitisation in Hong Kong. In Hong Kong, originators are often large commercial enterprises (such as operating entities that own a large portfolio of receivables that they could securitise) or financial institutions (such as banks that could securitise some of their loans). In recent years, increased activity is seen in non-bank financial institutions (NBFIs) securitizing trade finance receivables which are either owned by those NBFIs or purchased from other financiers.
c. **Eligible Receivables:** Deal specific asset eligibility criteria, mainly concerning asset quality such as repayment terms, debt aging, credit rating, delinquency ratios, free from any liens or encumbrances, freely transferrable (or subject to perfection requirements), are generated from eligible buyers and suppliers, and other bespoke requirements.
d. **Eligible Jurisdictions:** The jurisdiction of the receivables (including the jurisdictions of originator, buyers and suppliers) must be carefully selected to ensure that the assets are legally enforceable, and any perfection requirements adhered to, through legal due diligence.
e. **Underwriters and Placement Agents**: They are sometimes referred to as an "arranger" in securitisation in Hong Kong. They are involved in the underwriting of the ABS, in the case of an underwriter, or the placement of the ABS, in the case of a placement agent.
f. **Servicers**: Typically, in a securitisation, the originator will also take up the role of a servicer (or an "administrator" as it is sometimes called) to provide services with respect to the receivables transferred to the issuer.
g. **Back-up Servicers**: Independent service providers appointed to act in the capacity of the Servicers when the Servicers are in default or bankrupt.
h. **Cash Managers**: Responsible for managing the cash flows and ensuring that funds are properly allocated according to the transaction's structure. Their duties include managing collections from the underlying assets, allocating payments to the ABS holders, paying fees, and making other necessary disbursements.
i. **Investors**: An investor purchases the ABS from the issuer or underwriter, as applicable. Investors often tend to be financial institutions, insurance companies and private funds. Tranching is often involved to accommodate the various risk and profit appetites of different investors.
j. **Intercreditor Terms:** Determining key terms such as priority of payments, standstill provisions, enforcement rights, cross-collateralization and security, subordination and seniority, voting and consent rights, events of default and acceleration. Often deal specific and highly negotiated by investors. Waterfalls of payments can differ depending on whether the transaction is in the amortisation period

or the post-amortisation period.

k. **Trustees**: The note trustee acts under the instructions of the noteholders in respect of the actions being taken by the noteholders, among other duties. The security trustee, on the other hand, holds for the benefit of the noteholders as secured creditors the security created over the issuer's assets.

l. **Risk Retention :** Typically, the originator is required to retain 5% of the securitised assets (usually as Junior note holder although other or synthetic forms of retention is possible). Hong Kong securitisations are generally structured to comply with EU and UK risk retention requirements, particularly when they are targeted at EU or UK investors (e.g. investment funds) although there is no equivalent Hong Kong requirement for these non-bank originators.

5. Which body is responsible for regulating securitisation in your jurisdiction?

There is not a sole designated body responsible for regulating securitisation in Hong Kong. The regulators for securitisation in Hong Kong may include the HKMA and the Securities and Futures Commission ("**SFC**"), depending on the parties or the nature of activities involved in the transaction. HKMA is the principal regulator for AIs such as banks. For institutions that are not AIs such as various financial intermediaries licensed by the SFC (e.g. brokerage houses and investment managers), and when there is an issuance of securities involved, the principal regulator is the SFC. If the securitisation involves listing of the debt securities, the Hong Kong Stock Exchange (the "**Exchange**") issues listing rules (updated from time to time) and oversees the listing and trading of debt and other securities on the Exchange.

6. Are there regulatory or other limitations on the nature of entities that may participate in a securitisation (either on the sell side or the buy side)?

Currently, there are no regulatory or other limitations on the nature of entities that may participate in a securitisation (either on the sell side or the buy side). However, in reality, usually financial institutions such as banks. Investment managers and securities institutions are the major participants in the securitisation in Hong Kong, other than the SPV. Also see responses to question (2) in connection with Insurance Linked Securities and question (4) for key parties involved in securitisation transactions.

7. Does your jurisdiction have a concept of "simple, transparent and comparable" securitisations?

In January 2017, HKMA stated that the alternative capital treatment for "simple, transparent and comparable" securitisations would not be introduced in Hong Kong at this stage. Nevertheless, in the Supervisory Policy Manual ("**Module CR-G-12**"), the HKMA regards it as good practice for an authorised institution to take into account of the *Criteria for identifying simple, transparent and comparable securitisations* issued jointly by the BCBS and IOSCO in July 2015 in the authorised institution's policies and procedures for securitisation activities and adopt the criteria wherever it is feasible to do so.

8. Does your jurisdiction distinguish between private and public securitisations?

In Hong Kong, there are no significant differences between the public market and the private market in terms of the size of securitisation or the number of investors. However, public securitisations would be subject to approval, disclosure and prospectus registration requirements under the SFO and the CWUMPO, as applicable, while private securitisations would be exempted from such requirements if certain criteria are met (eg, offered to professional investors only and the to not more than 50 persons).

Typically securitisation transactions in Hong Kong involve issuance in the private market to sophisticated investors due to shorter timeframe for obtaining listing authorisation and a simpler disclosure requirement. For securitisation products aiming to be listed on the Hong Kong Stock Exchange, the Exchange's Listing Rules related to the public offering of debt securities should also be considered.

9. Are there registration, authorisation or other filing requirements in relation to securitisations in your jurisdiction (either in relation to participants or transactions themselves)?

Publicly offered securitisations in Hong Kong may be subject to the registration, authorisation or other filing requirements of the SFC. As noted above, publicly offered securitisations will also need to observe and comply with the Listing Rules of the Hong Kong Stock Exchange.

Securitisation is considered a type of structured investment. Specifically, offers of unlisted structured

products to the retail public in Hong Kong (including unlisted securitisation products) and the offering documents and advertisements in connection with such issuance must be authorized by the SFC under the SFO, unless an exemption applies.

In considering whether to grant an authorization, the SFC would normally review whether the application meets the disclosure and structural requirements in *the Code of Unlisted Structured Investment Products* (the "**SIP Code**") promulgated by the SFC.

Among other things, the SIP Code requires that the issuer prepares a product key facts statement, the issuer and the guarantor (if any) meet certain eligibility requirements, and post-sale cooling-off arrangements be provided for products exceeding a certain scheduled term

An issuer of an unlisted structured product should be duly incorporated in Hong Kong or established under the laws of a jurisdiction acceptable to the SFC. In addition to other requirements, it should also:

a. have a net asset value of at least HK$2 billion; and
b. (i) be either a bank regulated by the HKMA, a corporation licensed by the SFC, or an overseas banking entity subject to a standard of regulatory oversight in an overseas jurisdiction acceptable to the SFC; or (ii) have a top three investment grade credit rating awarded by at least one rating agency of international standing and reputation acceptable to the SFC.

Where the issuer does not meet either of the requirements above, the product must be guaranteed by a guarantor who meets the above requirements, or be collateralized in accordance with the requirements in the SIP Code.

Under the SIP Code, the issuer also has a continuing obligation to comply with certain requirements whilst its obligations remain outstanding. For instance, the issuer shall inform the SFC and all investors in the event that the issuer no longer meets any of the core requirements outlined in the SIP Code. The issuer has an ongoing obligation to also notify the SFC and all investors, to the extent permitted by applicable law, of any changes in circumstances, such as financial conditions, that could reasonably have a material adverse effect on the ability of the issuer (or the guarantor, if any) to perform its obligations in connection with the securitisation.

If the debt securities are listed on the Hong Kong Stock Exchange, they will be subject to the regulatory framework of the Listing Rules which govern the listing of debt securities on the Exchange, including:

a. in an public offering to retail investors, if the shares of the issuer or the guarantor (in a guaranteed issue) are not listed, the issuer or the guarantor must have total shareholders' funds of at least HKD100 million, and the nominal amount of each class of debt securities for which listing is sought must be at least HKD50 million; and
b. in an public offering to "professional investors" only, with effect from 1 November 2020, the issuer must have minimum net assets of HKD1 billion (unless it is a state corporation or its shares are listed) and is subject to a minimum issue size requirement of HKD100 million.

In addition, if the issuer is a Hong Kong company or a registered non-Hong Kong company under Part 16 of the Companies Ordinance, it is required to file a Form on Return of Allotment of Debenture or Debenture Stock pursuant to Section 316 of the Companies Ordinance within one month of the date of issue of the debt securities.

10. What are the disclosure requirements for public securitisations? How do these compare to the disclosure requirements to private securitisations? Are there reporting templates that are required to be used?

Hong Kong law does not mandate any disclosure requirements specifically for private securitizations. However, where a securitisation involves the issuance of debt securities to the retail public in Hong Kong, the issuance may be subject to the disclosure/prospectus registration regime under the CWUMPO and the SFO, subject to certain exemptions. Moreover, if the debt securities are to be listed on the Hong Kong Stock Exchange, the Listing Rules will also be applicable.

Prospectus

Under the CWUMPO, an offer of debentures (eg, ABS, among other types of securities) to the public in Hong Kong, unless exempted, must be issued with a prospectus that complies with the mandatory requirements set forth in the CWUMPO. For instance, the prospectus must specify the general nature of the business of the issuer, the investors' rights in respect of interest, security and redemption, and other information that is sufficient to enable a reasonable person to form a valid and justifiable opinion in investing in such debt securities, and also contain a risk/warning statement as specified in Part 1 of the Eighteenth Schedule to the

CWUMPO.

Additionally, unless exempted, before a prospectus is issued, it must have been authorised for registration by the SFC and a copy of it must have been registered with the Hong Kong Companies Registry.

Where a prospectus is not explicitly required under the law (eg, in certain private issuances), an offering circular or offering memorandum (and where applicable, pricing supplement) is normally produced for disclosure to investors nevertheless. Contents typically follow the prospectuses in public transactions, and generally include a summary of the transaction structure, descriptions of the relevant parties, the characteristics of the securitised assets and the terms and conditions of the notes, and lay out the material risks that prospective investors should consider when deciding whether or not to invest in the notes or securities. It is also customary to contain a statement restricting the offering documents' distribution to professional investors only.

Exemptions

Nevertheless, the CWUMPO and the SFO provide a number of exemptions in respect of the above requirements. The following two exemptions are often sought by the parties in a securitisation.

a. **Professional investors exemption** – an offer made to professional investors can be exempted from the above registration requirements. "Professional investor" is defined in Schedule 1 to the SFO and in the Securities and Futures (Professional Investor) Rules (Cap. 571D), and includes investors who are, among others, an authorised institution (eg, a bank), an authorised insurer, a collective investment scheme, any corporation or partnership having a portfolio of not less than HKD8 million; or total assets of not less than HKD40 million, and an individual having a portfolio of not less than HKD8 million.
b. **Private placement exemption** – an offer made to not more than 50 persons and containing a warning statement as specified in the Eighteenth Schedule to the CWUMPO. The warning statement generally stipulates that the contents of the prospectus have not been reviewed by any authority in Hong Kong and that the investors should exercise caution and obtain independent professional advice in relation to the contents of the prospectus.

Listing Rules

The Listing Rules governing the listing of debt securities offered to professional investors only set forth certain disclosure and publication requirements applicable to new issuances effective from 1 November 2020. Amongst other things, Issuers (and guarantors, if any) are required to publish listing documents (eg, offering circular and pricing supplement) on the website of the Hong Kong Stock Exchange on the date of listing, and state explicitly on the front cover of a listing document the intended investor is professional investors only and not appropriate as an investment for retail investors in Hong Kong.

There are also continuing obligations on the Issuers (and guarantors, where applicable) including to announce any information that may have a material effect on their ability to meet their obligations under the listed debt securities, disclose a default (including any cross-default triggered by a default on the other obligations of the issuer or the guarantor), insolvency, winding-up and similar applications or proceedings, or the appointment of manager or receiver; and quarterly announcements following any suspension of trading.

Other Disclosure Requirements

As noted in question (9) above, the SIP Code governing the issuance of unlisted structured investment products to the retail public in Hong Kong might also be applicable in a securitisation transaction as securitisation is considered a type of structured investment.

The SIP Code sets forth certain disclosure requirements, for instance, the prospectus for the debt securities should contain a description of (i) the key components of the transaction structure, (ii) the relevant parties, (iii) the terms and conditions of the notes, (iv) risks that might be involved in investing in the notes, (v) a description of the events of default in which the debt securities may be terminated before the scheduled maturity, (vi) the rights of the investors in the event of such termination and (vii) any other material information that ought to be disclosed to a prospective investor in order for it to make an informed decision.

11. Does your jurisdiction require securitising entities to retain risk? How is this done?

There is no specific credit risk retention requirement designed to ensure originators in securitisations retain certain economic exposure to the transactions for the purposes of aligning the parties' interests under Hong Kong law.

HKMA published the Module CR-G-12 with the aim of providing guidance to AIs on the vital elements of an

effective risk management system for credit risk transfer activities. Module CR-G-12 is not law but AIs are expected to comply with these guidelines nonetheless. See also response to question (13) below.

Where an AI acting as the originator in a securitisation transaction, HKMA recommends various actions expected to be taken by the AI including: (i) assessing its risk exposures to the subject transaction on an arm's-length basis according to its normal assessment and approval processes; and (ii) applying to the assets of the securitisation transaction a due diligence process, credit underwriting criteria and standards of analysis that are as rigorous as those for assets that are originated or acquired by the institution for its own retention, as well as ensuring that investors in the securitisation transaction have access to all materially relevant data concerning the transaction.

Where an AI acting as the investor, unless otherwise agreed with the HKMA, an investing AI should refrain from making investments in, or incurring an exposure to, a securitisation transaction where the originator has not disclosed its compliance with applicable risk retention requirements in any relevant foreign jurisdictions.

Similarly, although the SFC does not have specific risk retention requirements, it has established various codes and guidelines on risk management which are applicable to licensed persons and registered persons (including SFC registered AIs). The SFC's Code of Conduct sets out the general requirements on internal control procedures and financial and operational capabilities. More detailed requirements are also found in *the Management, Supervision and Internal Control Guidelines*, which include the requirements that licensed persons and registered persons should maintain appropriate trading limits, position limits and other credit risk management measures for carrying out proprietary trading. If a licensed fund manager is involved in the securitisation transaction, they should also comply with *the Fund Manager Code of Conduct*. For example, they should maintain an effective internal control and credit assessment system to evaluate the creditworthiness of the fund's counterparties and the credit risk of the fund's investments.

12. Do investors have regulatory obligations to conduct due diligence before investing?

In Module CR-G-12, HKMA requires AIs to conduct due diligence prior to investing in credit risk transfer products, including securitisation products. When acting as the originator in a securitisation, an AI is required to, among other things, assess its risk exposures to the subject transaction on an arm's-length basis in accordance with its normal and standard assessment and approval processes. It must also apply a due diligence process, credit underwriting criteria and standards of analysis to the assets of the securitisation transaction that are as rigorous as those used for assets that are originated or acquired by the institution for its own retention. Additionally, an AI must ensure that investors in the securitisation transaction have access to all materially relevant data relating to the transaction.

Pursuant to the Code of Conduct issued by the SFC, licensed persons and registered persons must ensure the suitability of their recommendation or solicitation (which includes conducting proper product due diligence). If a fund managed by a licensed fund manager is investing into the securitisation products, the fund manager also has a duty to conduct due diligence as they should exercise due skill, care and diligence in managing the fund, in accordance with *the Fund Manager Code of Conduct*.

13. What penalties are securitisation participants subject to for breaching regulatory obligations?

Module CR-G-12 is a non-statutory guideline. No direct penalties are stipulated for non-compliance with Module CR-G-12. Nevertheless, any failure to adhere to any of the guidelines in Module CR-G-12 may call into question whether the AI concerned continues to satisfy the minimum criteria for authorisation under the Banking Ordinance (Cap. 155).

Although codes and guidelines issued by the SFC do not have the force of law, if licensed persons and registered persons or licensed fund managers breach the codes and guidelines issued by the SFC, it will reflect adversely on the person's fitness and properness to remain licensed or registered.

Listing Rules are enforced by the Hong Kong Stock Exchange, in cooperation with the SFC (a statutory regulator) and other law enforcement authorities in their enforcement work. Regulatory responses can include disciplinary actions against issuers and guarantors for serious breaches and may also involve referrals to other law enforcement or regulatory bodies for conducts which fall within their jurisdictions. If the circumstances justify, the Exchange may direct a trading suspension, and in exceptional cases, cancel the listing of the debt securities in Hong Kong.

Where the debt securities are listed in a foreign

jurisdiction, if the issuer or the guarantor is involved in disciplinary actions taken by Hong Kong regulators, such events will also likely result in a breach of the regulatory obligations in the jurisdiction in which the debt securities are listed and may affect the listing in the foreign jurisdiction.

14. Are there regulatory or practical restrictions on the nature of securitisation SPVs? Are SPVs within the scope of regulatory requirements of securitisation in your jurisdiction? And if so, which requirements?

In Hong Kong, there are no regulatory restrictions on the nature of securitisation SPVs. The Companies Ordinance (Cap. 622) provides a legal framework for the establishment of companies and this includes SPVs.

An SPV is typically a limited liability company structured as an orphan entity and usually with its shares held by a charitable trust so that the SPV becomes bankruptcy remote. There are no specific regulatory requirements which an SPV needs to meet in and of itself, as the SPV in a typical securitisation is not engaged in any type of regulatory or licensed activity in Hong Kong. The structure of the transaction, the nature of the SPV's activities in Hong Kong and the place of incorporation of the SPV dictate whether any regulatory approvals or other licenses are required.

Although the SPV can be incorporated in any jurisdiction, including Hong Kong, more commonly the transaction parties will use an offshore incorporated SPV (such as a Cayman Islands limited liability company or a Luxembourg securitisation compartment) taken into considerations the legal framework, quality of service providers and tax advantages in the jurisdiction. In such cases, the insolvency law of the jurisdiction of the offshore SPV would apply in the event of an insolvency of the SPV. Hong Kong courts are not bound to recognise or enforce the laws of the SPV's jurisdiction, especially if they are considered contrary to public policies, for instance.

Depending on the transaction structure, the transaction parties often seek to incorporate the following aspects when establishing the SPV (in Hong Kong or other jurisdictions), to eliminate the originator's influence or control over the SPV:

a. The businesses that the SPV may undertake will normally be restricted to those in connection with the purchase and holding of the subject assets, the issuance of ABS and other ancillary matters. For instance, the SPV may not own assets other than the subject assets in the securitisation transaction and the SPV may not incur indebtedness or grant any security other than in connection with the ABS. The liabilities and assets of an SPV in a securitisation transaction should be ring-fenced from those in unrelated transactions. The underlying assets of securitisation are usually held through a trust arrangement, by a trustee or custodian.
b. Independent directors will typically be appointed for the SPV. Given that the SPV is an orphan entity, managers and investors would want to see that the originator does not have any control or influence over the SPV (other than on an arm's-length basis as an administrator or servicer, as applicable) and thus the SPV directors will usually be provided by a corporate service provider acting as share trustee and legal owner of the SPV and are not affiliated with or nominated by the originator. This could also be required by auditors where the transaction is seeking on off-balance sheet treatment.
c. The transaction parties will agree in the documentation that any recourse a party may have against the SPV in the securitisation will be limited to those assets owned and held by the SPV.
d. The transaction parties will agree in the documentation that they will not individually commence insolvency proceedings against the SPV, even if an event of default has occurred.

15. How are securitisation SPVs made bankruptcy remote?

To make the securitisation SPVs bankruptcy remote, in addition to setting up an orphan entity SPV as discussed above, a “true sale” of the assets should be made by the originator (as the seller) to the issuer (as the buyer). After the true sale, the relevant assets would no longer be the assets of the originator and, as noted above, will not form part of the originator's estate.

Currently, there is no doctrine of “substantive consolidation" in Hong Kong. A company (including an SPV) incorporated under Hong Kong law will have its own legal personality. Where the originator becomes bankrupt, an insolvency official would not have the power to consolidate the issuer's assets with those of the originator, unless exceptional circumstances, such as a “sham" or fraud exists.

In Hong Kong, a variety of techniques can be used in securitisation transactions to strengthen the insolvency remoteness of the transaction from the originator, for instance:

a. keeping the corporate activities of the SPV separate from those of the originator;
b. avoiding mingling of the SPV's assets with those of the originator;
c. ensuring none of the SPV's obligations are guaranteed by the originator;
d. limiting recourse to the SPV to the assets it has acquired;
e. where the originator is also acting as the servicer, it should be required to declare trusts over any receivables account and any intermediary or sub accounts which any receivables will be received and transferred into, and held under the name of the originator;
f. making sure the assignment or transfer of the receivable assets into the SPVs are absolute, irrevocable and not subject to any buyback options or arrangements which resemble a financial arrangement, which could be voided due to non-registration;
g. contractually restricting counterparties to the SPV from initiating insolvency proceedings;
h. imposing on the SPV a restrictive set of covenants limiting the activities it can undertake and, consequently, the liabilities it may become subject to;
i. granting security over an SPV's assets to protect them and the cash flows they generate against any unsecured third party creditors of the SPV;
j. undertaking solvency and corporate searches in respect of the originator; and
k. undertaking regular performance audits to ensure counterparties to the transaction are performing their roles properly.

Where a SPV issues multiple series of bonds or notes, for example in a repackaged product, there should be segregations of assets and liabilities between each series, such that the issuance proceeds from each series of notes will only be used by the SPV to purchase the relevant series' underlying assets, and the cash flow generated from which will only be used to repay the investors of the relevant series of notes. This can be coupled with the use of trust arrangements where the underlying assets of each series of notes are held under separate trusts. This ring-fencing mechanism may be achieved contractually if the SPV is incorporated in Hong Kong.

16. What are the key forms of credit support in your jurisdiction?

There are four main types of security interest that can be created in Hong Kong:

a. **Charges**. The chargor grants to the chargee equitable rights in property but the title in that property is not transferred to the chargee. The security can be taken by a fixed charge or a floating charge. If security is taken over an asset by a fixed charge or assignment, it is critical that the restrictions are imposed on what the chargor can do with that asset and the proceeds of that asset and to ensure that the chargee can exercise control over the asset and its proceeds. If the chargee has inadequate control over that asset or its proceeds, the fixed security might be recharacterised as a floating charge by the courts on the insolvency of the chargor. A floating charge will normally rank behind all fixed security and other creditors preferred by statute.
b. **Mortgages (legal or equitable)**. In the case of a legal mortgage, the chargor transfers the title in the property to the chargee. In the case of an equitable mortgage, no title is transferred. In the context of intangible rights, such as receivables, the transfer is typically done by means of an assignment.
c. **Pledges**. The pledgor passes the possession of the assets to the pledgee, and the pledgee has power to dispose of the asset on default by the pledgor.
d. **Liens**. Lien usually gives the person with possession a right to retain the asset until they are paid, but not to otherwise dispose of the asset.

17. How may the transfer of assets be effected, in particular to achieve a 'true sale'? Must the obligors be notified?

In order for the transfer of the subject assets to be valid and enforceable, the originator will transfer the assets to the issuer by way of an assignment and the assignment can be legal or equitable. In order to achieve a legal assignment, certain conditions will need to be satisfied, including:

a. the originator's entire (and not partial) interests in the assets are transferred to the issuer by way of an absolute assignment, rather than by an assignment by way of security;
b. the assignment must be in writing and signed by the originator;
c. the subject assets must not be restricted or prohibited in respect of such transfer, whether contractually or legally; and
d. the obligor of the subject assets (eg, the borrower of the loans) must be notified of such transfer.

If an assignment fails to meet any of the above conditions, it would still be enforceable but instead would be an equitable assignment until such time as it does

satisfy all these conditions. In particular, if the original obligor has not been notified of the transfer, although the transfer would not be ineffective solely because of such failure of notification, in the event of default by the obligor, the issuer (being the buyer of the assets) will not be able to enforce its rights directly against the obligor. Rather, the issuer would be required to join the originator in the proceedings against the obligor by adding the name of the originator as a claimant to any claim against the obligor. In practice, the issuer (as seller) is often required to pre-sign a Seller Power of Attorney, forming part of a Financing Receivables Purchase Agreement, granting powers to the SPV (as buyer) and/or the Security Trustee to serve notices on the underlying debtors or obligors where there are events of defaults, to facilitate direct enforcement against such underlying obligors.

Other than being an express written notice of assignment, there are no other requirements as to the form of the notice save that it must bring to the notice of the original obligor with reasonable certainty the fact that there has been an assignment of the assets so that the original obligor knows to whom it has to pay in the future and the notice must be unconditional. It would be prudent to ensure the notice was in English or Chinese, where necessary or applicable. A notice cannot be served on the obligor prior to the transfer of the assets as the transfer has not yet occurred.

The requirements governing the perfection of a legal assignment are more specifically set forth in Section 9 of the Law Amendment and Reform (Consolidation) Ordinance (Cap. 23).

18. In what circumstances might the transfer of assets be challenged by a court in your jurisdiction?

A transaction will not be treated as a 'true sale' for the sole reason that it is so labelled or characterised by the relevant parties. In determining whether a transaction constitutes a true sale, a Hong Kong court would look at several factors, including the parties' intention and the substance of the transaction. More specifically, the court would take into account the following distinguishing features in its determination, without limitation: (i) under the transaction documents, whether the originator has retained control over the assets, (ii) whether it has the contractual right to repurchase the subject assets and, if so, under what circumstances; (iii) in the event that the assets are realised by the issuer at a profit, whether the issuer is contractually required to account to the originator for any such profit and, in the event that the assets are realised by the issuer at a loss, whether the issuer is entitled to recover from the originator for such loss; and (iv) the intentions of the parties and whether the transaction effected under the sale agreement also properly reflects such intentions.

Judging by the above factors, if the court finds the transaction resembles a secured loan rather than a true sale, the court may recharacterise the transaction as a secured loan. The court may also consider other relevant factors in the overall circumstances of a securitisation transaction, but no absolute criteria have been established in the determination of whether a transaction constitutes a true sale or a secured loan.

Where the originator is a Hong Kong incorporated company and becomes insolvent, there is the possibility that the court may unwind the sale transaction, if it finds that the transfer of assets are subject to claw-back provisions under the CWUMPO and the CPO, such as a transaction at an undervalue or a disposition to defraud creditors.

19. Are there data protection or confidentiality measures protecting obligors in a securitisation?

Yes, in Hong Kong the 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 six data protection principles that are set out in schedule 1 of the PDPO. These six principles are:

1. The personal data must be collected for a lawful purpose and by means that are lawful and fair in the circumstances. The data subject must have been explicitly informed on or before the collection of his/her personal data of the purpose (in general or specific terms) for which the data is to be used and the classes of person to whom the data can be transferred.
2. Personal data must not, without the data subject's prescribed consent, be used for any purpose other than the purpose for which the data was to be used at the time of collection or a purpose directly related to it.
3. Personal data must not be kept longer than is necessary for the purpose for which the data is used and the user of the data must take practicable steps to ensure that personal data is accurate, having regard to the purpose of its use.

4. All practicable steps are taken to ensure that personal data is secure.
5. All reasonably practicable steps must be taken to ensure that a person can ascertain the policy of a person who uses data as regards personal data.
6. Providing data subjects with rights of access in relation to the personal data held by the user of the data and rights to request correction of any incorrect data.

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.

A person who's data is subject to a breach of the PDPO requirements can complain to the Privacy Commissioner for Personal Data about a suspected breach and claim compensation for damage caused to him/her due to a breach of the PDPO in civil proceedings. However, a breach of the PDPO does not invalidate the assignment of the receivables.

Banks and financial intermediaries are also required to handle information of individual customers with a duty to maintain privacy pursuant to the Code of Banking Practice or SFC's Code of Conduct, as applicable.

Data about or provided by obligors may also be protected by the more general Hong Kong legal and regulatory principles that require the protection of confidential information.

That said, the PDPO also contains a few exemptions to the above restrictions on use and disclosure of client data, for example, Data Protection Principle 3. provides exemptions for any use or disclosure of client data that is: (1) required or authorised by law or court order; (2) required in legal proceedings in Hong Kong or for exercising or defending legal rights in Hong Kong; (3) required for the purpose of due diligence in a prospective sale or merger; or with the client's express consent on the use and disclosure of the subject data. There are also various Hong Kong legislations which gives wide investigative powers to authorities to request for personal data for the purpose of conducting investigations, including the SFC, the HKMA, the Hong Kong Independent Commission against Corruption, and the Hong Kong Police Force.

20. Is the conduct of credit rating agencies regulated?

Providing credit rating services is a regulated activity supervised by the SFC. Any person who intends to prepare credit ratings for dissemination to the public or for distribution by subscription in Hong Kong or elsewhere, is required to be licensed for Type 10 regulated activity (providing credit rating services) from the SFC.

However, if a firm prepares credit ratings only for its own internal use, such as a bank's internal systems for assessing counterparty risks, it is unlikely that the firm will be regarded as “providing credit rating services” for the purposes of the SFO because the credit ratings would neither be intended for dissemination to the public or distribution by subscriptions, whether in Hong Kong or elsewhere, nor reasonably expected to be so disseminated or distributed.

21. Are there taxation considerations in your jurisdiction for originators, securitisation SPVs and investors?

Yes. The main taxation considerations are stamp duty and profits tax. Hong Kong does not impose withholding tax on businesses or individuals, except in certain limited circumstances involving royalties, but that would not generally be applicable in securitisation transactions.

Stamp duty may be payable for the transfer of interests in Hog Kong land and stocks. Generally, transfer of financial assets involving receivables (whether trade or lease receivables) is not subject to stamp duty.

Hong Kong stock is defined to include, among others, debentures, loan stocks, funds, bonds or notes denominated or redeemable in Hong Kong currency. Such transfer must be registered in Hong Kong under the Stamp Duty Ordinance (Cap. 117) (“**SDO**“) in order to be valid. Generally, most loans and receivables involved in securitisation transactions would not be regarded as “Hong Kong stock” for Hong Kong stamp duty purposes and, as such, no Hong Kong stamp duty would be chargeable.

However, transfers of Hong Kong dollar debt instrument in registered form may attract stamp duty, and payable in respect of the relevant contract notes for such transfers or sales of debt instruments. The applicable rate of stamp duty on such transfers was reduced from 0.13% to 0.1% for both the buyer and the seller, effective 17 November 2023, which is charged on the higher of the consideration or the fair market value of the debt instruments transferred, whichever is higher. However, debt securities issued in Hong Kong are usually denominated in US, EURO or RMB, and are usually not denominated in Hong

Kong currency.

Profits tax is chargeable on a person who is carrying on a trade, profession or business in Hong Kong in respect of the person's assessable profits arising in or derived from Hong Kong from such trade, profession or business. Nevertheless, as the SPV normally will not undertake any trade or business other than purchasing the financial assets for receiving receivables income and issuing the notes based on such income stream, it might not be deemed to be carrying on a trade, profession or business in Hong Kong.

Taxation of Foreign-sourced Income

The Inland Revenue (Amendment) (Taxation on Specified Foreign-sourced Income) Ordinance 2022 was enacted, providing for, with effect from 1 January 2023, a regime for taxing specified foreign-sourced income, including interest, dividends, disposal gains, and IP income derived from outside Hong Kong where:

1. the income is received in Hong Kong by a multinational enterprise carrying on a trade, profession or business in Hong Kong, regardless of its revenue or asset size; and
2. the recipient entity fails to:
    a. meet the economic substance requirement if the income is foreign-sourced interest, dividend or Disposal Gain;
    b. comply with the nexus requirement if the income is foreign-sourced IP income; or
    c. comply with the participation requirement if the income is foreign-sourced dividend or Disposal Gain.

Foreign-Sourced Income Exemption (FSIE)

However, the FSIE regime (effective from January 1, 2023 and further refined in 2024) exempts certain foreign-sourced incomes from local taxation, which might be relevant for SPEs which are by multinational enterprise entities (MNEs). Exemptions mainly concern disposal gains, aiming to ease burden of covered entities with international operations, providing intra-group transfer relief to MNEs for genuine commercial reasons like group restructuring, subject to anti-abuse rules.

The refinements to the FSIE regime in 2024 were made to bring it in line with the latest EU requirements in December 2022 that disposal gains, as a general class of income covered by the FSIE regime, should be subject to the economic substance requirement; and also includes new compliance-enhancing measures, including simplified reporting procedures, availability of advance tax rulings, and various administrative guidance with a view to reduce compliance burden and enhancing tax certainty/transparency.

To mitigate any potential tax liabilities, transaction parties can consider the following:

- Given Hong Kong's territorial basis of taxation, SPEs may structure their transactions to ensure that the income generated by the SPVs will not be considered sourced in Hong Kong. For example, by ensuring that the SPVs will not undertake any trade or business in Hong Kong other than purchasing the assets and issuing the notes, and that the securitisation assets (and the underlying receivables) will be considered foreign sourced. This would exempt such income from Hong Kong profits tax.
- Utilizing the FSIE Regime where foreign sourced income is received by the SPV in Hong Kong and the SPV is deemed a covered taxpayer –SPEs can leverage the FSIE regime to claim exemption from local tax, including, for example, an application for an advance ruling on compliance with the economic substance requirement.

In Hong Kong, tax advice is typically provided by accountants. Transaction parties should normally seek and consider such advice when structuring their transactions, particular when Hong Kong originator is involved.

22. To what extent does the legal and regulatory framework for securitisations in your jurisdiction allow for global or cross-border transactions?

HKMA seeks to establish a regulatory framework in line with international standards, in particular those issued by the Basel Committee on Banking Supervision and the Financial Stability Board, to facilitate the development of the global or cross-border transactions.

In order to promote co-operation in infrastructure financing (including infrastructure securitisation transactions), Hong Kong Mortgage Corporation Limited (HKMC), wholly owned by the Hong Kong SAR Government, has signed a MOU with Sinosure of China, and a Master Cooperation Agreement with the International Finance Corporation in 2019, in order to streamline the steps taken when both sides co-finance infrastructure projects by standardising the investment process and documentation. On 26 January 2021, the HKMC and MUFG Bank, Ltd (MUFG) signed a MOU, containing the principal terms for potential infrastructure loan sales by MUFG to the HKMC. It is expected that the

steady and high-quality infrastructure financing deal flow presented by MUFG is conducive to the HKMC's business objective of infrastructure loan securitisation after accumulating a diversified and sizeable asset portfolio.

In the context of cross-border marketing and solicitation activities, there is no rule under the SFO restricting financial intermediaries from marketing, advising or engaging in solicitation activities outside Hong Kong (but those activities will be subject to applicable regulations under the laws of the relevant jurisdictions). Similarly, under the SFO, the restriction on carrying out "regulated activities" in Hong Kong (eg, dealing in securities, advising on securities or asset management) does not distinguish between foreign or local corporations. All intermediaries (whether or not incorporated in Hong Kong) should obtain a relevant licence from either the HKMA or the SFC if they wish to provide cross-border licensed or regulated services and or market securitisation or other structured products targeting the Hong Kong public.

23. How is the legal and regulatory framework for securitisations changing in your jurisdiction? How could it be improved?

In order to achieve closer alignment with the securitisation framework in the UK, US and Europe, Hong Kong has been seeking to refine its legal and regulatory framework for securitisations, by taking into consideration of the regulatory developments in the UK, US and Europe.

Basel III

HKMA's guidelines for implementing Basel 3.1 standards have come into effect in Hong Kong since January 1, 2025. These include credit risk, operational risk, and output floor standards, and market risk and credit valuation adjustment risk standards.

The Basel 3.1 reforms may impact securitization activities in Hong Kong, particularly through:

- Higher capital charges for certain asset classes, encouraging banks to use securitization (especially SRT transactions) for risk management and capital relief.
- Enhanced risk sensitivity in capital requirements, which could affect the appeal of securitization for some assets.

Given the complex nature of Basel 3.1 reforms, regulatory bodies in UK, EU and the United States continue to assess the readiness of financial institutions and the broader economic implications of their promulgated standards, which could mean new standards or amendments to Basel regulations, influencing future securitisation activities.

Significant Risk Transfer

The Hong Kong Monetary Authority (HKMA) has issued guidelines on significant risk transfer (SRT), primarily for banks and financial institutions involved in securitisation transactions. These guidelines were designed to align with the Basel III framework, particularly the requirements for capital adequacy and the recognition of effective risk transfer in securitisations.

The key aspects of the SRT guidelines by the HKMA are:

1. Significant Risk Transfer (SRT) Requirement:
    - A securitisation transaction must transfer significant credit risk associated with the underlying assets to the investors or third parties to be recognized as an effective risk transfer for regulatory capital purposes.
    - The significant risk transfer must be assessed based on whether the originator (usually the bank) retains an exposure that is meaningful and substantial relative to the total risk transferred to investors. The risk should not primarily remain with the originator.
2. Criteria for SRT:
    - The HKMA requires that a material portion of the risk be transferred, and substantially all of the credit risk associated with the underlying assets should be shifted from the originator to other investors.
    - If the risk transfer is deemed insufficient (i.e., the originator retains too much risk), the transaction may not be recognized as a true securitisation, and the securitised assets may remain on the originator's balance sheet for capital charge purposes.
3. Assessment of Risk Retention:
    - Risk retention must be clearly defined and agreed upon, ensuring that the originator retains some interest in the performance of the underlying assets.
    - The retained portion should be aligned with the long-term interests of the originator and should not excessively undermine the transfer of risks to investors.
4. Impact on Regulatory Capital:
    - For capital adequacy purposes, if a securitisation fails to meet the significant risk transfer criteria, a bank as originator

may be required to hold additional regulatory capital against the securitised assets. This is to account for the retained risks that have not been effectively transferred.

In summary, the HKMA's SRT guidelines ensure that banks and financial institutions in Hong Kong are only able to offload risk through securitisations if they genuinely transfer significant credit risk to investors and not merely retain a large portion of that risk themselves. This is aimed at protecting the financial system and ensuring that securitisation transactions are not used to evade regulatory capital requirements.

24. Are there any filings or formalities to be satisfied in your jurisdiction in order to constitute a true sale of receivables?

Please refer to our answers to question 17 above. An absolute, unconditional and irrevocable written notice of assignment is required to be duly served on the original obligor or debtor in order to effect a legal assignment of the receivables and constitute a true sale of receivables. More requirements of a 'true sale' were discussed in question 18 above.

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