

## **Taiwan : Transfer of loans and security issues**

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**Although Taiwan's securitisation market is not active after the global financial crisis in 2008, the financial institutions have developed different exit strategies for loan and other assets on their balance sheets.**

Taiwan's securitisation legal framework was constituted in 2002 and its securitisation products first appeared on the market in 2002 until the occurrence of the global financial crisis in 2008. After the global financial crisis, the governmental authority was very strict in granting its approval for new securitisation products. From 2011 to 2014 there was only one new securitisation of lease debts which came to the market in 2014. Based on the statistics provided by the Financial Supervisory Commission, the authority of financial institutions and products, as of March 31, 2015, there have been 52 financial assets securitisation products (including six RMBS, 38 ABS and eight ABCP) at a total issuing size of around NT\$554bn (about US\$18.47bn) and 17 real property securitisation products (including nine REATs and eight REITs) at a total issuing size of around NT\$78bn (about US\$2.7bn). Among the above 69 securitisation products, only 12 are currently outstanding. In spite of the above, in view of the internationalisation policy adopted by the Chairman of the Financial Supervisory Commission in connection with the financial products and financial service providers, we hope that the financial securitisation products might slowly return back to the market.

The Real Estate Securitisation Statute and the Financial Assets Securitisation Statute are two major legislations governing securitisation in Taiwan. Although the securitisation products based on the above two statutes are limited and the governmental authority is still sceptical toward securitisation products, the financial institutions have developed different exit strategies for loans and other assets on their balance sheets, such as sale of a loan, sale of participation in a syndication loan to another bank or sale of distressed debts to assets management companies, which do not require the approval of, filing or registration with the governmental authority.

In this article, we will consider some of the factors in relation to the transfer of loans and related security issues based on our experience of advising different participants in the market.

### **Transfer of loans**

#### **Transfer method**

In Taiwan, a seller generally sells loans to a purchaser by way of entering into a loan purchase agreement through which the seller sells and transfers its claim against the obligor and the purchaser pays the agreed consideration. The transfer of a claim is effective against the obligor only when notice of the transfer has been given to the obligor. In Taiwan, there is no unified terminology used to describe selling loans to a purchaser. Sale, transfer and assignment are commonly used in the transactions.

#### **Formalities**

Generally, it is unnecessary for the sales of loans to be evidenced by a formal written contract. An

agreement between the parties to the transaction, either orally or in writing, would suffice, unless the law requires otherwise. For instance, an agreement in writing is required for an instalment sale between enterprises and the consumer according to the Consumer Protection Act. A contract may be presumed to exist based on evidence including but not limited to the behaviour of the parties, communication between the parties and customary practices.

### Choice of law

The parties are allowed to choose the law applicable to the sale of the loans, provided that if a foreign law is chosen by the parties, the relevant provisions of the foreign law would not be applied to the extent that the courts of Taiwan hold that (i) the application of such provisions would be contrary to the public order or good morals of Taiwan; or (ii) such provisions would have the effect of circumventing mandatory and/or prohibitive provisions of Taiwan law. If the sale of loans is between two financial institutions which have different nationalities and no law is specified in the purchase agreement, the Law Governing the Application of Laws to Civil Matters Involving Foreign Elements ("Application of Laws") provides that the effect on the assignment of the credit right against the obligor shall be governed by the law governing the credit right. For instance, under Taiwan law, if the loan agreement is governed by Taiwan law, the transfer loan should follow the requirements of Taiwan law. Therefore, the seller or the purchaser should give a notice to the obligor upon the transfer of the loans in order for the transfer to take effect against the obligor.

### Obligor notification

Under the Civil Code, if the loan agreement is silent on the transferability of loans, the seller may transfer the loans against the obligor to the purchaser. Notice is required in order for the sale of the receivables to be effective against the obligor. If the loan agreement prohibits such a transfer, the loan cannot be transferred unless obtaining the obligor's consent to the sale of loans. In addition, if the credit rights to the loans are subject to attachment, the seller is unable to transfer such credit rights.

There is no special requirement on the form of notice or how it must be delivered. In addition, there is no time limit beyond which notice is ineffective, and therefore notice of a sale may be delivered to the obligor even after insolvency proceedings against the obligor have commenced. A notice of sale can also be delivered to the obligor even after insolvency proceedings against the seller have commenced, provided that (i) the sale of the loan occurs prior to commencement of insolvency proceedings against the seller; and (ii) the bankruptcy administrator does not cancel the sale. However, in each of the above two cases, the sale will take effect against the obligor only when the obligor is notified.

Additional or different requirements for sale of promissory notes, mortgage loans and marketable debt securities.

1. Promissory notes: Under Taiwan law, transfer of promissory notes issued by the obligor requires: (i) endorsement made by the seller on the promissory notes to the purchaser; and (ii) delivery of the promissory notes to the purchaser. However, if the promissory note is prohibited by the note issuer (such as the obligor) from transfer by way of the endorsement, the promissory note cannot be transferred to the purchaser.
2. Mortgage loans: The transfer of the mortgage loan from the seller to the purchaser requires a notice to the obligor.

There are two types of mortgages: a general mortgage and a mortgage with a maximum secured amount. A general mortgage is to secure a specific debt owed by the debtor to the creditor, while a mortgage with a maximum secured amount is to secure a variety of debts owed by the debtor to the creditor up to a specified maximum amount. In case of a general mortgage, the mortgage securing

the loan generally will be transferred simultaneously to the person (e.g. the purchaser) to whom the secured loan is transferred, while the aforementioned person can foreclose the mortgage only upon duly registering itself as the mortgagee with the local land office or, for a chattel mortgage, other competent authorities depending on the type of chattel.

In the case of a mortgage with a maximum secured amount, before the underlying debts are crystallised and confirmed, the mortgage will not tag along with the transfer of the loan. After the underlying debts are crystallised and confirmed, the mortgage securing the loan will be transferred simultaneously to the person to whom the secured loan is transferred.

3. Marketable debt securities: Sale and perfection of marketable debt securities is subject to different requirements depending on the types of securities. For example, corporate bonds may be issued in bearer form or registered form. For registered corporate bonds, sale and perfection of such bonds between the seller and the purchaser requires endorsement made by the bond holder on the bond certificate to the purchaser and delivery of the bond certificate to the purchaser. Further, in order for the transfer to take effect against the issuing company, the name and residence of the transferee should be recorded in the counterfoil of the corporate bonds. In contrast, if the corporate bonds are in bearer form, delivery of the corporate bonds would suffice. Where the corporate bonds are registered and deposited with the securities depository and clearing institution in Taiwan (i.e. Taiwan Depository & Clearing Corporation, "TDCC") or in global form or in scripless form, the sale and perfection of the corporate bonds should be made by way of book-entry

## **Security issues**

### **Security related to the loans**

Under the Civil Code, as a general principle, the security interest will be transferred concurrently with the transfer of secured loans with a few exceptions, such as the mortgage with a maximum secured amount as mentioned above. However, in order for the purchaser to foreclose the security, certain formalities are required to be completed based on different types of security interest involved. For instance, where the security interest is a mortgage, the purchaser shall register itself with the local authorities as the new mortgagee in order to foreclose the mortgage. To give another example, if the security interest is a pledge over personal property, the possession of the pledged personal property shall be delivered to the purchaser in order for the purchaser to foreclose the personal property.

### **Purchaser security for funding**

In Taiwan, if the purchaser of loans grants security over purchased loans in favour of the providers of its funding, such security interest is generally granted in the form of a pledge of rights. Under the Civil Code, in order to effectively pledge credit rights, the execution of a pledge agreement is required. In addition, in order for the pledge of the credit rights to take effect against the obligor, a notice to the obligor is required. Furthermore, the pledgor should deliver the instruments (such as loan agreements) evidencing the loans to the pledgee; however, this is merely an obligation of the pledgor but not a requirement for the perfection of the pledge. The pledge of credit rights is not required to be registered with local government authorities.

Under the Application of Laws, validity of a pledge over a right shall be determined based on the law governing the creation of rights. For instance, if the loan is governed by Taiwan law, whether a pledge over a credit right on the loan is validly created and perfected should be reviewed in accordance with Taiwan law. Therefore, in the event that the creation and perfection of a pledge is governed by a foreign law and inconsistent with the Taiwan law, such a pledge would not be recognised by a Taiwan court.

### Bank account

Taiwan recognises pledges over a bank account. Under Taiwan law, a pledge over a bank account requires a written agreement between the pledgor and the pledgee and a notice to the bank. However, there is no such concept of a floating charge under Taiwan law. In practice, in the case of a pledge over a current account, the pledgor normally would deliver, on a monthly basis, the statement of credit balance of its bank accounts on which a pledge is created to the pledgee, and the accounts receivable represented by the number shown in the aforementioned statement would be the subject receivables of pledge. Accordingly, all cash flowing into the bank account from enforcement forward will not be subject to the pledge or the pledgee's control unless the pledgor agrees to additionally pledge such cash in favour of the pledgee and notify the account bank of the pledge. In addition, if the pledgee agrees the pledgor to withdraw cash from the bank account, the pledge created over such cash in the bank account will be eliminated.

Whether a Taiwan court will recognise a security governed by foreign law over a Taiwan bank account (for instance, pledge governed by foreign law over the Taiwan bank account) depends on whether the creation and perfection of such security complies with Taiwan law as explained above. But recognition of such security will still be subject to the court test as we have yet found any court precedent or judgment recognising such security.

### Pledge over promissory notes and marketable debt securities.

1. Promissory notes: The Law of Negotiable Instruments does not explicitly provide the method to create a pledge over promissory notes and it is not common to create a pledge over a promissory note in Taiwan. Nonetheless, most of the scholars argue that the holders of promissory notes may pledge the promissory note by following the general provisions in connection with a pledge over securities under the Civil Code. In other words, (i) endorsement (including a notation as to the purpose for which the pledge is created) made by the grantor on the promissory notes (not applicable in the case where the payee is not named); and (ii) delivery of the same to the grantee are required to perfect the creation of pledge over the promissory notes.
2. Marketable debt securities: As to creating a pledge over marketable debt securities, in general, the method to perfect pledge over debt securities is identical to that applied to securities as stated above (i.e. (i) endorsement made by the pledgor on the debt securities; and (ii) delivery of the same to the pledgee) unless otherwise provided by laws or regulations. In addition, for debt securities registered with the TDCC without physical certificates, creation of a pledge over such securities should be made through the TDCC and with relevant documents submitted as required by the TDCC.

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