Asia Pacific Guide to Lending and Taking Security - Philippines

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# When considering whether to lend

## 1. Is it necessary or advisable for any lender, arranger, facility agent or security agent to be licensed, qualified or otherwise entitled to carry on business in this jurisdiction: (a) by reason only of its execution, delivery or performance of the finance documents; or (b) to enable it to enforce its rights under the finance documents?

**Execution, delivery and performance of the finance documents**

Based on Philippine Supreme Court decisions and Securities and Exchange Commission (SEC) opinions, arguably, a foreign lender, arranger, facility agent or security agent is not required to obtain a license from the SEC by reason solely of its execution, delivery or performance of finance documents, provided that the finance documents relate to a single or isolated transaction and there is no purpose or intention to do any other business within the country.

As a rule, a foreign corporation is required to obtain a license from the SEC if the activities that the foreign corporation intends to carry out will constitute the foreign corporation doing business in the Philippines. On the other hand, if the activities that the foreign corporation intends to undertake do not constitute doing business in the Philippines, the foreign corporation is not required to obtain a license from the SEC.

There is no exclusive list of activities that constitute doing business in the Philippines. However, the Foreign Investments Act and its implementing rules provide for a nonexclusive enumeration of specific activities that constitute doing business in the Philippines1.

The Philippine Supreme Court has ruled that a foreign corporation is not deemed to be doing business if its commercial dealing is limited to a single agreement or is isolated or is an occasional transaction and indicates no element of continuity of conduct in that respect. Further, the SEC has opined that a foreign corporation is not doing business by lending money to a Philippine resident, where the loan is merely incidental to, and not a substantial part of, its corporate business, or where the loan is made offshore. Hence, if the execution, delivery and performance of the finance documents relate to a single or isolated loan transaction, and there is no purpose or intention to do any other business within the country, it can be argued that the foregoing activities do not constitute doing business in the Philippines and, as such, obtaining a license from the SEC is not required.

The SEC license is also referred to as the primary license of a foreign corporation. In addition to the SEC license, a foreign corporation that will engage in lending activities in the Philippines generally and on a continuing basis is required to obtain a secondary license from other regulatory agencies. Depending on the scope of the lending activities, such a foreign corporation must obtain a secondary license to operate either as a bank, a financing company or a lending company.

**Enforcement of the finance documents**

Whether a license is required to enable a foreign corporation to enforce its rights under the finance documents depends on whether the foreign corporation is doing business in the Philippines.

It is not necessary for a lender, arranger, facility agent or security agent that is not "doing business in the Philippines" to be licensed for it to enforce its rights under the finance documents. Conversely, a lender, arranger, facility agent or security agent that is doing business in the Philippines without a license is barred from filing or intervening in any action, suit or proceeding in any court or administrative agency of the Philippines, unless it obtains the required license to transact business in the Philippines. However, it may be sued in relation to any valid cause of action recognized under Philippine law.

1 The implementing rules of the Foreign Investments Act provide that "doing business" will include soliciting orders, service contracts and opening offices, whether liaison offices or branches; appointing representatives or distributors, operating under full control of the foreign corporation, domiciled in the Philippines or that in any calendar year stay in the country for a period totaling 180 days or more; participating in the management, supervision or control of any domestic business, firm, entity or corporation in the Philippines; and any other act or acts that imply a continuity of commercial dealings or arrangements and contemplate to that extent the performance of acts or works, or the exercise of some of the functions normally incident to and in progressive prosecution of commercial gain, or of the purpose and object of the business organization. The following acts will not be deemed "doing business" in the Philippines:

Mere investment as a shareholder by a foreign entity in domestic corporations duly registered to do business and/or the exercise of rights as such investor

Having a nominee director or officer to represent its interest in such corporation

Appointing a representative or distributor domiciled in the Philippines that transacts business in the representative's or distributor's own name and account

Publishing a general advertisement through any print or broadcast media

Maintaining a stock of goods in the Philippines solely for the purpose of having the same processed by another entity in the Philippines

Consignment by a foreign entity of equipment with a local company to be used in the processing of products for export

Collecting information in the Philippines

Performing services auxiliary to an existing isolated contract of sale that are not on a continuing basis, such as installing in the Philippines machinery it has manufactured or exported to the Philippines, servicing the same, training domestic workers to operate it and similar incidental services

## 2. Will any lender, arranger, facility agent or security agent be deemed to be resident, domiciled, carrying on business or subject to tax by reason only of the execution, delivery, performance or enforcement of the finance documents?

No. However, the income of any lender, arranger, facility agent or security agent is subject to tax if the income originated from sources within the Philippines. Interest income is deemed to originate from sources within the Philippines if the debtor is a resident of the Philippines or the loan is used in the Philippines.

## 3. Are there any regulatory reporting requirements that lenders must observe in connection with those transactions?

Generally, reporting requirements are imposed by the Bangko Sentral ng Pilipinas (BSP), the Philippine central bank, on BSP-supervised institutions (such as banks that are operating in the Philippines). Further, for foreign loans of residents, the reporting requirements under Philippine foreign exchange regulations are imposed on the resident borrower.

## 4. Is it necessary to establish a place of business in your jurisdiction in order to enforce any provision of the finance documents?

If a foreign corporation is deemed to be "doing business" in the Philippines, it is required to obtain a license from the SEC. To obtain the license, the SEC requires the foreign corporation to establish a principal place of business in the Philippines.

On the other hand, if a foreign corporation is not considered to be doing business, it is not necessary to obtain a license from the SEC and, for that purpose, establish a principal place of business.

## 5. Is a foreign bank/financial institution permitted to approach local entities for business?

If a foreign bank/financial institution that is not licensed in the Philippines goes to the Philippines and approaches or solicits local entities for business, such institution may be deemed to be doing business without the required licenses from the SEC and the BSP.

The possible consequences of a foreign bank being deemed to be "doing business" in the Philippines without authorization include the foreign bank being barred from maintaining or intervening in any legal or administrative action or proceedings and the imposition of a fine, imprisonment of the responsible directors and officers, or both, at the court's discretion.

# When lending to borrowers

## 1. Are there any restrictions in relation to the type of borrower who may borrow foreign currency or in relation to the term of foreign currency and/or the amount of foreign currency borrowed by local entities?

We are not aware of any specific restrictions in relation to the type of borrower that may borrow foreign currency. However, in general, if the lender or guarantor is a bank operating in the Philippines, the total amount of loans, credit accommodation and guarantees extended by it to any borrower must not exceed 25% of the net worth of that bank. Loans secured by acceptable (low-risk) security are considered non-risk loans and are generally excluded from this limit.

Further, except with the prior approval of the BSP, the combined outstanding loans and guarantees extended by a bank to a single director, officer or stockholder of such bank and its related interest should not exceed 15% of the bank's total loan portfolio or 100% of the bank's net worth, whichever is lower. Dealings of a bank with any of its directors, officers or stockholders and their related interest will be upon terms as favorable to the bank as the terms offered to others.

## 2. Are there any restrictions on the rate of interest or default interest that may be charged?

With the removal of interest ceilings on loans or forbearance of money, goods or credits by the BSP, contracting parties are generally free to stipulate the interest rates to be imposed in relation to monetary obligations. However, courts may invalidate interest rates if found to be excessive or unconscionable.

Where interest is agreed to be paid but the interest rate is not stated in the relevant agreement, the default rate of interest prescribed under BSP regulations is 6% per annum.

## 3. Are there any restrictions on particular lenders or classes of lender entering into credit transactions with borrowers?

There are generally no restrictions on particular lenders or classes of lender entering into credit transactions with borrowers in the Philippines.

However, where a foreign lender or lenders intend to engage in the lending business in the Philippines, it is necessary to obtain, in addition to a license from the SEC, a secondary license as either a bank, a financing company or a lending company. The type of secondary license will depend on the scope of lending activities that the foreign lenders will engage in, and the granting of such license is subject to meeting the requirements under the relevant laws and regulations.

## 4. Are there any exchange controls that will apply to payments to be made in foreign currencies or to foreign lenders?

Yes. Unless specifically exempt under the relevant BSP regulations, prior BSP approval must be obtained for foreign loans (i.e., loans from foreign lenders regardless of denomination) or foreign currency-denominated loans of (a) public sector entities or (b) private sector entities if guaranteed by government corporations and/or government financial institutions.

Further, other foreign currency-denominated loans extended by foreign lenders to private sector borrowers are generally required to be registered with the BSP to enable the borrower to purchase foreign exchange from the Philippine domestic banking system to service payment of the loan obligations.

## 5. Is there any requirement to deduct or withhold tax from any amounts to be paid or repaid to a lender (whether domestic or foreign)? If so, at what rate must tax be deducted and from what kinds of payment?

Interest payments to foreign entities are subject to withholding tax. Under Philippine tax law, a nonresident foreign corporation not engaged in trade or business in the Philippines is generally subject to a 20% final withholding tax on gross interest received in relation to loans granted to Philippine residents. The 20% final withholding tax on gross interest may be reduced under the provisions of Philippine tax treaties with the country where the nonresident foreign corporation is domiciled.

## 6. Are there any “thin capitalization” or other rules that may limit the extent to which interest payments may be deducted for tax purposes?

Under Philippine law, the amount of interest paid or incurred within a taxable year will be allowed as a deduction but should be first reduced by 20% of the interest income of the taxpayer subjected to final tax, if any.

## 7. Are there any registration, notarization, translation or reporting requirements in relation to the loan documents?

Yes. Registration with the BSP of a foreign currency loan extended by a foreign lender to a private sector entity is required if foreign exchange will be purchased from the local banking system to service payments on the loan (principal and interest).

Notarization

Notarization is not required for the validity or enforceability of a loan document.

Further, under BSP regulations, no public and/or publicly guaranteed foreign loan that is submitted to the BSP for approval and/or registration will be approved and/or registered if the loan documents are notarized.

However, notarization is useful. Under evidence rules, a notarized document is presumed to be signed by the person whose name appears on the document and the document can be presented in court without further proof of its due execution and authenticity.

Credits without special privilege that appear in a public (i.e., notarized) instrument are granted preference as provided in Article 2244 of the Civil Code of the Philippines ("**Civil Code**"). However, under BSP regulations, no public and/or publicly guaranteed foreign loan that is submitted to the BSP for approval and/or registration will be approved and/or registered if the loan documents are notarized.

Translation

Translation of loan documents into the local language is not required under Philippine law.

Reporting

See the response under question 3 in the section "When considering whether to lend" for the reporting requirements of the BSP.

For income tax purposes, the withholding agent (i.e., the borrower) must report the loan transactions to the Bureau of Internal Revenue on remittance of the withholding tax.

## 8. Are there any stamp, documentary, registration, notarization or other taxes, duties or fees chargeable in relation to the loan documents? If yes, what are the amounts and when are they payable?

For loan agreements, Philippine law generally requires the payment of a document stamp tax (DST) at a rate of PHP 1.50 (USD 0.03) for every PHP 200 (USD 4) of the amount of the loan. At the time of publication, the notarization of each document costs from PHP 200 to PHP 400 (USD 4 to USD 8).1

1. Conversion of PHP to USD is at an assumed exchange rate of USD 1 = PHP 50

## 9. Does the law recognize the subordination of the debt that a debtor owes to one creditor to that which the debtor owes to another creditor? If yes, how is this usually effected?

Yes. Philippine law recognizes subordination agreements, subject to the concurrence and preference of certain credits prescribed under Philippine law. These are discussed in the answer to question 10 of this section and in question 1 of the section "If taking security."

## 10. Are there any classes of unsecured and unsubordinated creditor whose claims against a debtor would rank equally with or above those of the debtor’s other unsecured and unsubordinated creditors (e.g., the claims of employees and tax authorities or the claims of creditors under particular kinds of instrument)? If yes, what classes of creditors are preferred?

See the response to question 1 of the section "If taking security."

Further, the Foreign Rehabilitation and Insolvency Act (FRIA) prescribes the order of priority in which the obligations of a debtor must be paid in an insolvency situation (after the debtor's assets are liquidated), as follows:

Special preferred debts under the Civil Code in relation to specific personal or movable property of the debtor and in relation to specific real or immovable property and real rights of the debtor.

Ordinary preferred debts under the Civil Code, provided that, for the purposes of implementing the liquidation plan under the FRIA, debts for services rendered to the debtor by employees or laborers have first preference.

Ordinary claims, which are claims approved and allowed in the liquidation proceedings and not falling into (a) or (b) above.

Within each of the above three categories (i.e., special preferred debts, ordinary preferred debts and ordinary claims), the Civil Code lists the specific classes of debts that are preferred as discussed in the response to question 1 of the section "If taking security." The debts due to the creditors are satisfied in accordance with the list based on a descending order of priority. For example, under the first category of special preferred debts in relation to the debtor's specific movable property, the first item in the list, which is duties, taxes and fees due to the government, enjoys preference over all other claims listed within that category.

## 11. Are there any consumer protection or similar laws that apply if credit is made available to individuals or other classes of debtor? If yes, what laws are applicable?

Yes. The Truth in Lending Act and the BSP Manual of Regulations for Banks and Manual of Regulations for Non-Bank Financial Institutions apply. BSP Regulations on Financial Consumer Protection also detail how creditors must deal with customers in relation to disclosure and transparency, protection of client information, fair treatment, effective recourse and financial education.

## 12. Are there any prohibitions or limitations on the extent to which a company can give financial assistance for the purchase of: (a) its own shares or those of any affiliated company; or (b) assets owned by it or any affiliated company?

There are no specific prohibitions or limitations under Philippine law.

However, a Philippine corporation may provide financial assistance in connection with the acquisition of shares in itself or its parent corporation if the following events occur:

Its articles of incorporation do not contain an express restriction prohibiting the financial assistance.

The extension of the financial assistance is authorized in the purpose clause of the articles of incorporation, and it can reasonably be shown to be for the benefit of and in furtherance of the corporation's primary purposes.

The applicable corporate approvals are obtained.

# If taking security

## 1. Are there any classes of unsecured and unsubordinated creditor whose claims against a debtor would rank equally with or above those of the debtor’s secured creditors?

The Civil Code provides for the preference of credits classified into the following categories:

Special preferred credits listed under Articles 22411 and 22422

Ordinary preferred credits listed under Article 22443

Credits not included in Articles 2241, 2242 and 2244 enjoy no preference

Under each of Articles 2241 and 2242, duties, taxes and fees due to the government enjoy first-tier preference. All other special preferred nontax credits stand on the second-tier preference to be satisfied equally and pro rata out of any residual value (after payment of the taxes) of the specific property to which the credits relate.

In satisfying several preferred credits that are registered with the Register of Deeds, the rule is the priority of credits in the order of the time of registration.  
  
With reference to other property of the debtor to which no specific liens attach under Articles 2241 and 2242, Article 2244 enumerates claims and credits that enjoy preference in the order stated. However, the Philippine Supreme Court has ruled that credits of laborers (i.e., employment claims) under Article 2244 will enjoy first-tier preference. On the other hand, the last preferred credits in Article 2244(14) enjoy preference among themselves in the order of priority of the dates of the instrument and the judgments.

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1. Article 2241 of the Civil Code provides the following.

With reference to specific movable property of the debtor, the following claims or liens will be preferred:

duties, taxes and fees due thereon to the state or any subdivision thereof

claims arising from misappropriation, breach of trust or malfeasance by public officials committed in the performance of their duties, on the movables, money or securities obtained by them

claims for the unpaid price of movables sold, on the movables, so long as they are in the possession of the debtor, up to the value of the same; and if the movable has been resold by the debtor and the price is still unpaid, the lien may be enforced on the price; this right is not lost by the immobilization of the thing by destination, provided that it has not lost its form, substance and identity; neither is the right lost by the sale of the thing together with other property for a lump sum when the price thereof can be determined proportionally

credits guaranteed with a pledge, so long as the things pledged are in the hands of the creditor or those guaranteed by a chattel mortgage, upon the things pledged or mortgaged, up to the value thereof

credits for the making, repair, safekeeping or preservation of personal property, on the movable thus made, repaired, kept or possessed

claims for laborers' wages, on the goods manufactured or the work done

for expenses of salvage, upon the goods salvaged

credits between the landlord and the tenant, arising from the contract of tenancy on shares, on the share of each in the fruits or harvest

credits for transportation, upon the goods carried, for the price of the contract and incidental expenses, until their delivery and for 30 days thereafter

credits for lodging and supplies usually furnished to travelers by hotel keepers, on the movables belonging to the guest as long as such movables are in the hotel, but not for money loaned to the guests

credits for seeds and expenses for cultivation and harvest advanced to the debtor, upon the fruits harvested

credits for rent for one year, upon the personal property of the lessee existing on the immovable leased and on the fruits of the same, but not on money or instruments of credit

claims in favor of the depositor if the depositary has wrongfully sold the thing deposited, upon the price of the sale

In the foregoing cases, if the movables to which the lien or preference attaches have been wrongfully taken, the creditor may demand them from any possessor within 30 days from the unlawful seizure.

2. Article 2242 of the Civil Code provides the following.

With reference to specific immovable property and real rights of the debtor, the following claims, mortgages and liens will be preferred and will constitute an encumbrance on the immovable or real right:

taxes due upon the land or building

for the unpaid price of real property sold, upon the immovable sold

claims of laborers, masons, mechanics and other workpeople, as well as of architects, engineers and contractors, engaged in the construction, reconstruction or repair of buildings, canals or other works, upon said buildings, canals or other works

claims of furnishers of materials used in the construction, reconstruction or repair of buildings, canals or other works, upon said buildings, canals or other works

mortgage credits recorded in the Registry of Property, upon the real estate mortgaged

expenses for the preservation or improvements of real property when the law authorizes reimbursement, upon the immovable preserved or improved

credits annotated in the Registry of Property, in virtue of a judicial order, by attachments or executions, upon the property affected and only as to later credits

claims of co-heirs for warranty in the partition of an immovable among them, upon the real property thus divided

claims of donors of real property for pecuniary charges or other conditions imposed upon the donee, upon the immovable donated

credits of insurers, upon the property insured, for the insurance premium for two years

3. Article 2244 of the Civil Code provides the following.

With reference to other property of the debtor, to which no specific liens attach, the Civil Code states that the following claims or credits will be preferred in the order named:

proper funeral expenses for the debtor or children under their parental authority who have no property of their own, when approved by the court

credits for services rendered to the insolvent by employees, laborers or household helpers for one year preceding the commencement of the proceedings in insolvency

expenses during the last illness of the debtor or of their spouse and children under their parental authority, if they have no property of their own

compensation due the laborers or their dependents under the laws providing for indemnity for damages in case of a labor accident or illness resulting from the nature of the employment

credits and advancements made to debtors to themselves and their families, during the last year preceding the insolvency

support during the insolvency proceedings and for three months thereafter

fines and civil indemnification arising from a criminal offense

legal expenses and expenses incurred in the administration of the insolvent's estate for the common interest of the creditors, when properly authorized and approved by the court

taxes and assessments due the national government other than those taxes and assessments on specific property of the debtor form a lien on such property

taxes and assessments due any province other than those taxes and assessments on specific property of the debtor that form a lien on such property

taxes and assessments due any city or municipality other than those taxes and assessments on specific property of the debtor that form a lien on such property

damages for death or personal injuries caused by a quasi-delict

gifts due to public and private institutions of charity or beneficence

credits which, without special privilege, appear in (a) a public instrument or (b) in a final judgment, if they have been the subject of litigation; these credits will have preference among themselves in the order of priority of the dates of the instrument and of the judgments, respectively

## 2. May security given by a company rank in a specified order so as to secure liabilities owed to different creditors of the company in that order and, if that is not possible, is it viable for parties to enter into a contractual arrangement for the purposes of moderating this order?

Yes. Philippine law does not prohibit the ranking of security to secure liabilities owed to different creditors by contractual stipulation, subject to the statutory preference of credits discussed in question 1 of this section.

## 3. Does this jurisdiction recognise the concept of floating security or similar equivalent (i.e., security over a changing pool of assets that the company giving the security is free to buy, sell and generally deal with)?

No. Philippine law generally does not recognize the concept of floating security.

The Civil Code recognizes specific types of security — guarantee/surety, real estate mortgage, antichresis — and the creation of security interests over personal property under the Personal Property and Security Act.

A security agreement may provide for the creation of security interest in future property, but the security interest in that property is created only when the grantor acquires rights in it or the power to encumber it.

## 4. If so, are there any practical reasons why floating security is difficult to take, maintain or enforce?

See the answer to question 3 of this section.

## 5. May security be granted to a trustee to be held on trust for the lenders from time to time, in such a way that a change of lenders does not require new security to be taken?

Under Philippine law, the assignment of a credit includes all the accessory rights, such as a guarantee, mortgage, pledge or preference. Further, legal and contractual subrogation (i.e., change in lenders) transfers to the persons subrogated (i.e., the new lenders) the credit with all the rights thereto, either against the debtor or against third persons, be they guarantors or mortgagors. Hence, it is not necessary to create or take a new security in the event of a change of lenders. However, in a contractual subrogation, the original lender, debtor, security provider and new lender must consent to the subrogation. The consent of the debtor and security provider may be given in advance in the relevant documentation.

## 6. If not, are there any techniques that can be used to achieve substantially the same effect (e.g., parallel debt structures)?

Not applicable.

## 7. If an agent holds security for the lenders rather than a trustee, is it necessary to take new security on a change of lenders? If no, why not? If yes, are there ways to structure the transaction to avoid such a requirement?

No. See answer to question 6 of this section.

## 8. Under the laws of this jurisdiction, is there any class of asset over which it is difficult or impossible to grant effective and perfected security, or in relation to which any security granted will be of limited effect?

Certain activities or areas of investment are subject to foreign equity restrictions pursuant to the Philippine Constitution and statutes. These activities or areas of investment are listed in the Foreign Investment Negative List.

Among the activities that are subject to foreign equity restrictions is the ownership of land in the Philippines. Only Philippine citizens and corporations or associations, at least 60% of whose capital is owned by Philippine citizens, may own land in the Philippines.

Real property, including land, may be mortgaged to secure the performance of obligations. However, if the mortgagee is disqualified to own land in the Philippines, the mortgagee is not permitted to bid or take part in any foreclosure sale of the mortgaged property, but may take possession after default for the purpose of foreclosure for a period not exceeding five years from actual possession. On the other hand, foreign banks that are authorized to do banking business in the Philippines are allowed to bid and take part in foreclosure sales of real property mortgaged to them, as well as to avail of enforcement and other proceedings and, accordingly, take possession of the mortgaged property for a period not exceeding five years from the actual possession. However, title to the property will not be transferred to the foreign bank. If the foreign bank is the winning bidder, during the five-year period, it will transfer its rights to a person or entity that is qualified to own land in the Philippines.

In relation to shares of stock, a stockholder may pledge or constitute a chattel mortgage over its shares of stock in a Philippine corporation in favor of a foreign lender. However, if the Philippine corporation is subject to a foreign equity limitation, the foreign lender can acquire and take title to the pledged or mortgaged shares only to the extent of the applicable foreign equity limitation.

## 9. Under the laws of this jurisdiction, are there any restrictions on offshore lenders taking security over any class of asset?

There are generally no restrictions to offshore lenders taking security over assets in the country. However, their resulting interest in the security may be limited by foreign ownership restrictions in place over a certain class of assets. For instance, in foreclosure of land used as collateral for the loan, the foreign lender may not participate in the public auction or in any other manner obtain ownership over the land. On the other hand, foreign banks that are authorized to do banking business in the Philippines are allowed to bid and take part in foreclosure sales of real property mortgaged to them, as well as to avail of enforcement and other proceedings and, accordingly, take possession of the mortgaged property for a period not exceeding five years from the actual possession. However, title to the property will not be transferred to the foreign bank.

## 10. Must a company receive a corporate benefit in return for giving a guarantee or security? In particular, are there restrictions on the grant of upstream and cross-stream guarantees and security? If yes, briefly what is the effect of these laws?

Yes. Philippine law requires a corporate benefit to be received before a Philippine corporation can provide a guarantee or pledge or mortgage of its assets as security for the performance of the loan obligations of another person or corporation.

The Philippine Supreme Court has held that the primary obligation of the directors of a corporation is "to seek the maximum amount of profits for the corporation" and it characterized a director's position as a "position of trust." In line with the directors' fiduciary duty, directors who willfully and knowingly vote for or assent to patently unlawful acts of the corporation or who are guilty of gross negligence or bad faith in directing the affairs of the corporation are liable jointly and severally for all damage suffered by the corporation, its stockholders and other persons as a result of those acts by those directors.

## 11. What type of security interests does your jurisdiction recognise, e.g., pledge, charge, mortgage, hypothecation? In relation to each type of security interest, please state the formalities required to create and perfect that security.

The Civil Code recognizes four types of security arrangements — guarantee/surety, real estate mortgage, antichresis — and the creation of security interests over personal property through security agreements. A description of the common types of security and their formalities are set out below.

Guarantee/surety

In a contract of guarantee, a person, known as a guarantor, is bound to the creditor to fulfill the obligation of the principal debtor if the principal debtor fails to do so. If the guarantor is bound with solidary (i.e., jointly and severally) with the principal debtor, the guarantee contract is called a suretyship and the guarantor a surety.

A guarantee must be in writing. A guarantee is not presumed; it must be express and it cannot extend to more than what is stipulated therein.

Subject to certain exceptions, a guarantor cannot be compelled to pay the creditor, unless the latter has exhausted all the property of the debtor and resorted to all legal remedies against the debtor (known as exhaustion). On the other hand, a surety is not entitled to the benefit of exhaustion.

Real estate mortgage

A mortgage is a contract whereby the debtor guarantees to a creditor the fulfillment of an obligation by subjecting specific real properties as security in the event of the nonfulfillment of the secured obligation. The essential requisites are as follows:

The real estate mortgage must be constituted to secure the fulfillment of a principal obligation.

The mortgagor must be the absolute owner of the property.

The mortgagor must have free disposal of its property. In the absence thereof, the mortgagor must be legally authorized for the purpose.

To be binding against third persons, a real estate mortgage must be in writing and recorded in the Registry of Deeds.

Security agreement over personal property

Philippine law permits parties to freely enter into any form of security arrangement over movable property, if the arrangement is consistent with the rules in the Personal Property Security Act.

To be valid, a security agreement must be contained in a written contract signed by the parties. The following perfect security interests: (a) registration of a notice with the registry; (b) possession of the collateral by the secured creditor; and (c) control of the investment property and deposit account.

## 12. Are there any registration, translation or notarization requirements in relation to security, guarantees, subordination or intercreditor documents?

See the answer to question 11 of this section.

Translation of security, guarantee, subordination or intercreditor documents into the local language is not required under Philippine law. However, under the Personal Property Security Act, the security agreement for the creation of security over personal assets must provide for the language to be used in agreements and notices. The grantor must be given the option to have the agreement and notices in Filipino.

## 13. Are there any stamp, documentary, registration, notarization or other taxes, duties or fees chargeable in respect of security, guarantees, subordination or intercreditor documents? If yes, what are the amounts and when are they payable?

A DST must be paid to the Bureau of Internal Revenue. The DST is imposed on pledges or mortgages based on the secured amount at the following rates:

DST of PHP 40 (USD 0.8), when the amount secured does not exceed PHP 5,000 (USD 100)

Additional tax of PHP 20 (USD 0.4) on each PHP 5,000 or a fractional part of it in excess of PHP 5,000 (USD 100)

The Registry of Deeds requires the payment of a registration fee based on the value of the consideration of the security transaction.

At the time of publication, the notarization of each document costs from PHP 200 to PHP 400 (USD 4 to USD 8).

# If things go wrong

## 1. Please provide a brief description of the insolvency regime. In particular what rights and duties do unsecured and secured lenders have on the insolvency of a debtor? Are there any other matters of concern?

Several remedies are available to financially distressed individuals or corporations. Individuals may apply for the suspension of payments or liquidation, while corporations may seek: (a) corporate rehabilitation (or restructuring), which may be either (i) court-supervised rehabilitation, (ii) pre-negotiated rehabilitation or (iii) an out-of-court restructuring agreement; or (b) liquidation.

Corporate rehabilitation is available to debtors that may be restored to a condition of successful operation and solvency. A court-supervised rehabilitation occurs when a rehabilitation court is appointed to resolve the matter of rehabilitation. In a pre-negotiated rehabilitation, the insolvent debtor, by itself or jointly with any of its creditors, petitions the court for the approval of a pre-negotiated rehabilitation plan that has been endorsed or approved by a certain number of creditors as required under the law.1 In an out-of-court restructuring agreement, there is a rehabilitation plan, but it does not need court approval to be effective.

Lenders should file their claims with the rehabilitation court at least five days before the initial hearing date. During the pendency of rehabilitation proceedings, secured lenders retain their rights to the security but actions in connection with their claims, including the enforcement against the security, are stayed until the court orders otherwise or until the rehabilitation proceedings are terminated. The rehabilitation receiver will call a meeting with the debtor and all classes of creditors to discuss the rehabilitation plan. All classes of lenders and creditors can vote on the approval of the rehabilitation plan to be proposed by the rehabilitation receiver.

Liquidation proceedings are based on the fact that the debtor does not have enough assets/property to cover its obligations. Liquidations may be voluntary (i.e., applied for by the debtor itself) or involuntary (i.e., applied for by three or more creditors that satisfy the relevant requirements).

If the court finds the petition or motion for liquidation sufficient in form and substance, it issues a liquidation order. A liquidation order is an order issued by the court that declares that the debtor is insolvent and orders the liquidation or dissolution of the debtor. On the issuance of the liquidation order, the debtor is dissolved, and legal title and control of its assets are vested in the liquidator. The effects of the liquidation order are different for secured and unsecured creditors.

An unsecured creditor is not permitted to bring a separate action against the debtor for the collection of debts owing to the unsecured creditor. Any action already pending will be transferred to the liquidator to accept or settle or to contest. The court will hear and resolve the matter, and any final and executory judgment against the debtor will be filed and allowed in court.

A liquidation order will not affect the right of a secured creditor to enforce its security. Therefore, a secured creditor may do either of the following:

Waive its right under its security, prove its claim in the liquidation proceedings and share in the distribution of assets of the debtor

Maintain its rights under the security or lien

1. Under the Republic Act No. 10142, the pre-negotiated rehabilitation plan must be endorsed or approved by creditors holding at least two-thirds of the total liabilities of the debtor, including secured creditors holding more than 50% of the total secured claims of the debtor and unsecured creditors holding more than 50% of the total unsecured claims of the debtor.

## 2. Is it possible to obtain a moratorium before insolvency?

Yes, but only for financially distressed individuals who may apply for a suspension of payments.

For financially distressed entities, the moratorium, pursuant to a stay or liquidation order, is only issued upon an application for insolvency (i.e., either corporate rehabilitation or liquidation).

## 3. When a company is the subject of a formal insolvency procedure, can the company’s pre-insolvency transactions be set aside?

Yes. Any transaction by the debtor or involving its assets entered into prior to the issuance of the stay order or liquidation order may be rescinded or declared null and void on the grounds that it was executed with the intent to defraud the creditor or creditors or that it constitutes an unfair preference.

## 4. When can a lender enforce its security? Can security be enforced out of court following an event of default (or other contractual trigger event), or is a court order required? Are there any restrictions that apply before a lender may enforce its security?

The requirements for a lender to be able to enforce its security depend on the type of security that will be enforced. The types of security and their requirements for enforcement are discussed below.

**Guarantee**

Generally, a guarantor (but not a surety) cannot be compelled to pay the creditor unless the following events occur:

All of the property of the principal debtor has been exhausted.

The creditor has exhausted all of its legal remedies in relation to the principal debtor.

Therefore, the creditor must perform the following: 

The creditor must first file a case against the principal debtor alone.

In that case, the creditor must ask the court to notify the guarantor.

The creditor may hold the guarantor liable only after judgment has been obtained against the principal debtor and the principal debtor is unable to pay.  
  
On the other hand, the benefit of exhaustion does not apply to a surety. Hence, the creditor may sue, separately or together, the principal and the surety.

**Real estate mortgage**

A real estate mortgage may be enforced extrajudicially if the mortgage instrument expressly allows extrajudicial foreclosure. On the other hand, if there is no stipulation allowing extrajudicial foreclosure, the mortgage must be enforced judicially.

In an extrajudicial foreclosure, the foreclosure sale at public auction can proceed after the filing of an application for extrajudicial foreclosure with the executive judge that has jurisdiction over the area where the relevant real property is located and upon compliance by the applicant with all of the requirements. The sheriff will conduct the foreclosure sale.  
  
For judicial foreclosure, a petition for foreclosure must be filed in the proper court that has jurisdiction over the area where the relevant real property (or a portion of the real property) is situated.

**Security arrangement over personal property**

A secured creditor may take possession of the collateral without a judicial process if the security agreement so stipulates. However, this is assuming possession may be taken without breach of the peace. If possession cannot be taken without breach of the peace, the secured creditor is entitled to an expedited hearing for a court order granting possession of the property.  
  
After default, a secured creditor may sell or otherwise dispose of the collateral, publicly or privately. It may also propose to the debtor and grantor to take all or part of the collateral in total or partial satisfaction of the secured obligation.

## 5. Do any limitation periods apply in relation to bringing an action to enforce security?

Yes. Under the Civil Code, an action to enforce a right arising from written contracts must be enforced within 10 years from the time the cause of action accrues (i.e., upon failure by the debtor to perform the secured obligation when due).

## 6. Is there any particular way in which secured assets must be liquidated on enforcement (e.g., by auction or court sale)?

Upon the default of the secured obligation, the creditor is not entitled to automatically appropriate the pledged or mortgaged property. The creditor is permitted to recover its credit from the proceeds of the foreclosure sale of the property at public auction through a public officer in the manner provided by law.

The proceeds of the foreclosure sale of a pledged or mortgaged property will be applied in the following order:

The costs of the sale

The amount of the principal obligation and interest

The junior encumbrances

In a pledge, the sale of the pledged property extinguishes the principal obligation, whether or not the proceeds of the foreclosure sale are equal to the amount of the principal obligation, interest and expenses in a proper case. If the proceeds are more than the principal obligation, the debtor is not entitled to the excess unless there is a contrary stipulation in the pledge agreement. If the proceeds are less, the creditor is not entitled to recover the deficiency and a contrary stipulation is void.

In a mortgage, if the proceeds from the foreclosure sale are not sufficient to satisfy the mortgage debt, the creditor is entitled to obtain a deficiency judgment. The deficiency judgment may be satisfied from other properties of the debtor.

## 7. Are there any particular legal or practical difficulties or delays in enforcing security?

Generally, as set out in the answer to question 4 of this section in relation to the enforcement of a guarantee, the guarantor (but not a surety) cannot be compelled to pay the creditor unless all of the property of the principal debtor has been exhausted. The creditor may hold the guarantor (but not a surety) liable only after judgment has been obtained against the principal debtor and the principal debtor is unable to pay. This benefit of exhaustion is subject to exceptions, such as insolvency or an express waiver by the guarantor.  
  
The creditor cannot automatically appropriate the security or dispose of it in the event of default. Any stipulation to the contrary is void. A foreclosure sale conducted in accordance with the prescribed requirements and procedure is necessary to enforce a mortgage. Further, in the case of insolvency, as discussed in the answer to question 1 of this section, the right of a creditor to enforce a security may be suspended by the court on the commencement of the rehabilitation proceedings of the insolvent debtor until the proceedings are terminated either due to the failure of the rehabilitation or the successful implementation of the rehabilitation plan.  
  
Another practical consideration is that cases in the Philippines generally take considerable time to be decided. Securities that are sought to be enforced through court proceedings for foreclosure are often not immediately enforced. Therefore, creditors typically prefer extrajudicial proceedings.

## 8. In relation to enforcement, are there any specific requirements to be borne in mind if the lender is a foreign entity?

See the answer to question 8 of the section "If taking security."

In addition, security agents and trustees are typically Philippine residents.

## 9. Is there any reason why you think that arbitration rather than litigation might be advantageous in resolving disputes under the finance documents, and if so, why? Please outline the relative merits of arbitration and litigation, including the ease of enforcement of foreign judgments and foreign awards from different jurisdictions. Is it possible to rely on a hybrid enforcement provision that allows the lenders to opt for either arbitration or litigation as they see fit?

Arbitration is generally more advantageous to foreign lenders than litigation. Disputes submitted to arbitration are more speedily resolved. Furthermore, the rules on arbitration are more favorable to foreign investors as the parties mutually agree on these rules. A valid arbitration clause in a loan contract allows a foreign awardee to enforce an award in the Philippines. The disadvantage of arbitration is that it is a more costly process in the Philippines than litigation proceedings.

## 10. Are asymmetrical jurisdiction clauses enforceable? (By this we mean clauses that allow the lenders, but not the borrowers, to make certain choices in relation to choice of jurisdiction and how to litigate. These types of clauses allow the lenders, but not the borrowers, to commence proceedings in any court they choose, but restrict the borrowers to commencing proceedings in one jurisdiction only. This may also allow the lenders, but not the borrowers, to choose whether to litigate the finance documents before a court or to submit to arbitration in relation to them, but restrict the borrowers to either litigation or arbitration, as specified in the agreement).

The validity of asymmetrical jurisdiction clauses has not yet been decided in the Philippines. It may be argued that these clauses are valid under the "freedom to contract" clause provided in the Civil Code, i.e., that "contracting parties may establish such stipulations, clauses, terms and conditions as they may deem convenient, provided they are not contrary to law, morals, good customs, public order or public policy."

However, the Philippine Supreme Court has invalidated clauses granting exclusive jurisdiction to non-Philippine courts. The court's reasoning was that a Philippine court's jurisdiction, being determined by law, cannot be limited by mere stipulation.

Moreover, asymmetrical dispute resolution clauses providing for litigation and arbitration, with options given to the lender but not the borrower, might be viewed as being contrary to public policy.

# Working digitally

## 1. Is it possible for documents to be executed electronically (whether by the manual insertion of a digital signature or the use of an e-signing platform) under the laws of this jurisdiction? If so, is this limited to only particular types of finance documents?

Yes, Philippine law permits the use of e-signatures on electronic documents without any limitation as to the type of finance document involved. An electronic signature on the electronic document will be equivalent to the signature of a person on a written document, if that signature is proved by showing that a prescribed procedure, not alterable by the parties interested in the electronic document, existed when the following occurs:

A method is used to identify the party sought to be bound and to indicate that party's access to the electronic document necessary for its consent or approval through the electronic signature.

The method is reliable and appropriate for the purpose for which the electronic document was generated or communicated, considering all circumstances, including any relevant agreement.

It is necessary for the party sought to be bound, in order to proceed further with the transaction, to have executed or provided the electronic signature.

The other party that is authorized and enabled to verify the electronic signature and to make the decision to proceed with the transaction is authenticated by the same.

## 2. Where the witnessing of a signing is contemplated, is it possible for the witness to verify the signature over a live video call?

It is possible for the witness to verify the signing over a live video call. However, if the document is to be notarized, witnessing over video call is not permitted. Under the 2020 Interim Rules on Remote Notarization of Paper Documents, when there is a witness to the instrument, the principal should provide the notary public with a video showing proof that the witness actually saw the principal sign and each witness should declare that they personally witnessed the signing of the instrument or document.

## 3. Is it possible to register/perfect security electronically without wet ink signatures?

Yes, under the Electronic Commerce Act, all offices and agencies of the government that accept the filing of documents and/or issue permits, licenses or certificates of registration will accept the creation, filing or retention of documents in the form of electronic data messages or electronic documents. Thus, government agencies are bound to accept electronic documents with electronic signatures.

However, where notarized documents are required, then the wet ink signature of the notary is required. The Rules on Remote Notarization do not permit Philippine notaries public to notarize a document using their e-signature. Instead, the document is to be couriered to them for them to sign the document.

## 4. Are there any other legal restrictions that may prevent the parties from executing a finance transaction electronically?

Yes. As stated in the answer to question 3 of this section, in the case of documents required to be notarized, the notarization may not be done electronically.

# Contributors

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This chapter was prepared by Quisumbing Torres.

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