Asia Pacific Guide to Lending and Taking Security - Philippines

When lending to borrowers

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# 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.

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