Asia Pacific Guide to Lending and Taking Security - Philippines

If taking security

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# 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).

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