Asia Pacific Guide to Lending and Taking Security - Hong Kong SAR

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?

No.

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

The MLO regulates the charging of excessive rates of interest by any person (other than an AI), whether or not that person is a money lender and regardless of whether an exemption from the MLO applies. Under the MLO, an effective annual interest rate in excess of 48% is illegal. In addition, an effective annual interest rate that exceeds 36% but does not exceed 48% is presumed to be extortionate and a Hong Kong court may reopen the underlying transaction.

Under the MLO, an agreement that provides, directly or indirectly, for the payment of compound interest to a money lender is illegal. Similarly, an agreement that provides for the payment of interest to a money lender at a default rate is illegal, except for simple interest on the principal amount of the amount in default at the same rate at which interest is charged on the principal amount that is not in default.

Although the MLO does not (and, therefore, the restrictions referred to above do not) apply to an AI, the Code of Banking Practice (a nonstatutory code that the HKMA expects all AIs to comply with) recommends that AIs also observe the MLO interest rate and default interest restrictions in relation to their dealings with customers who are individuals. However, there are no particular statutory restrictions on excessive interest rates or default interest in relation to loans by AIs to customers that are not individuals (e.g., Hong Kong companies). In any case, a provision in a loan agreement requiring any person to make any extra or increased payment as a result of a breach or a default (for example, a default interest provision) would be unenforceable if a Hong Kong court considered it a penalty.

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

No, subject to the comments in the answer to question 1 of the “When considering whether to lend” section in relation to the licensing requirements for lenders.

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

No.

# 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?

No.

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

Hong Kong does not have a thin capitalization regime.

Generally, interest expenditure is deductible for tax purposes where it is incurred in the production of assessable profits. However, because certain types of interest income are exempt from tax in Hong Kong, there are specific situations in which deduction on interest may be limited to remove asymmetry that can arise where interest is deductible to the payer but is not assessable in the hands of the recipient. Broadly, these restrictions are concerned with situations where:

The interest payment is secured or guaranteed by a deposit that is made by the borrower (or its associate) to certain persons and the interest income on the deposit is not taxable in Hong Kong

The interest arises from an arrangement under which the interest payable is paid, directly or through an interposed person, back to the borrower (or a person connected or associated with the borrower) that is not assessed (or is chargeable at a reduced tax rate under certain tax concessions) on the interest income paid back

Failure to comply with these tests does not necessarily disallow deduction of the interest expense in its entirety. The restriction on interest deduction is confined to the portion of the interest relating to the portion of the loan, debenture or debt instrument that failed the tests and in respect of the time in which the failure persisted.

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

No, provided that the loan documents do not contain any provisions creating registrable security. (See also the answer to question 1 of the section "When considering whether to lend" in relation to reporting requirements, as well as question 12 of the section "If taking security" in relation to security documents).

# 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?

No, provided that they do not contain any provisions creating registrable security. (See the answer to question 12 of the “If taking security” section in relation to security documents).

# 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?

It is possible to provide contractually for the subordination of the debt a debtor owes to one creditor (the subordinated creditor) to that which the debtor owes to another creditor (the senior creditor). This is usually effected by the debtor and the senior and subordinated creditors entering into a subordination deed (or, alternatively, an intercreditor deed, which usually sets out more detailed priority and intercreditor arrangements between the senior and junior creditors).

Under a typical contractual subordination, the senior and subordinated creditors agree that the subordinated creditor will not exercise its rights in respect of the relevant debt until the senior creditor has been paid in full.

Case law has confirmed the validity of contractual subordination arrangements in which a creditor agrees to waive, postpone or subordinate its debt to the debts of other creditors both before and on insolvency. However, any arrangement that interferes with the rights of other creditors might be called into question on the liquidation of the company.

# 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?

Certain classes of unsecured creditors are preferred by statute. These include certain debts due to employees (e.g., wages and salaries up to a specified amount) and the government (e.g., taxes and duties). In the case of the liquidation or winding-up of a Hong Kong company, the expenses of the winding-up (including the liquidator's remuneration) have priority over all other debts (preferential or otherwise) and any charge on goods distrained may also take priority over the rights of unsecured creditors. In addition, statutory insolvency set-off (see the answer to question 1 of the section "If things go wrong") may effectively confer priority on an unsecured creditor.

A lender to a Hong Kong entity should also be aware of the Partnership Ordinance. According to the Partnership Ordinance, where a loan is made at an interest rate that varies with the borrower's profits or where repayment is made by way of a share of the borrower's profits, the lender may be subordinated to the borrower's other creditors and, in certain cases, this arrangement may result in the lender being held to be a partner of the borrower unless it is clear from a consideration of all the relevant facts and the finance documents that the lender is not intended to be considered to be a partner of the borrower.

# 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?

Apart from the BO, the MLO and the Code of Banking Practice (a nonstatutory code that the HKMA expects all AIs to comply with) provide general principles and guidelines that an AI should observe in dealings with individual customers, including in making available loans or other facilities and in taking the benefit of guarantees or security. Where a licensed money lender is a member of the Licensed Money Lenders Association (LMLA), the nonstatutory LMLA Code of Practice provides similar guidance.

In addition, various general consumer protection ordinances may provide additional protections in the context of a lending relationship with a bank or financial institution (and, in particular, where the counterparty is a consumer and where it is dealing with the bank or financial institution in the ordinary course of business), such as the following:

The Control of Exemption Clauses Ordinance limits the effect and extent of exemption and the limitation of liability clauses if they are not considered reasonable.

The Unconscionable Contracts Ordinance provides that certain contractual terms are not enforceable if they have an unconscionable effect.

The Supply of Services (Implied Terms) Ordinance provides certain terms in the contractual relationship that suppliers of services, including lenders, must observe (e.g., an implied term to use reasonable care and skill).

The Trade Descriptions Ordinance outlines that it is an offense to use false trade descriptions or to provide false, misleading or incomplete information (this ordinance does not apply to AIs).

The Personal Data (Privacy) Ordinance provides statutory privacy protections for individuals.

# 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?

Under the CO, there are certain prohibitions on a company, private or public, incorporated in Hong Kong providing financial assistance in connection with the acquisition of shares in itself or its parent company.

The CO prohibits a company ("**Target**") from giving financial assistance directly or indirectly for the purpose of acquiring shares in itself or its holding company or for the purpose of reducing or discharging liabilities so incurred. Financial assistance includes assistance given by way of guarantee, security, indemnity, loan, novation or other similar agreement, gift or any other assistance by which the company's net assets are reduced to a material extent.

This only applies to financial assistance given by the Target or by any of its subsidiaries. Therefore, the prohibition does not apply where the assistance is given by a parent in respect of an acquisition of its subsidiary's shares or by a subsidiary to assist in the acquisition of its sister subsidiary's shares. Moreover, the prohibition applies only to financial assistance given by a Hong Kong subsidiary for the acquisition of its own shares or shares in its Hong Kong holding company. It does not restrict a Hong Kong subsidiary from giving financial assistance for the purpose of acquiring shares in its offshore-incorporated holding company.

The restrictions above apply to financial assistance given before or at the same time as the acquisition and to reduce or discharge a liability incurred for the purpose of (i.e., after) the acquisition.

There are some exceptions to the prohibition, including where the giving of financial assistance is authorized in accordance with the so-called whitewash procedure.

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