



Taking security in Vietnam

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Taking security in Vietnam

Introduction

Vietnamese laws regarding security transactions are based on civil law concepts. Although the legislation relating to secured transactions is fairly well developed, there are certain important limitations that should be borne in mind, and practical implementation and enforcement may be uncertain.

This note provides a brief overview of the types of security available to secure a borrower's obligations under Vietnamese law, based on the texts listed and defined in the Annex.

Secured transactions in general

Classic security, in which the beneficiary creditor is entitled to either seize a secured asset or sell it and apply the proceeds of sale to satisfy its claim, exists under Vietnamese law in two forms: (i) a mortgage and (ii) a pledge. Other types of security used in Vietnam include performance bonds, security deposits and escrow deposits, but these only confer contractual rights on the creditor as against third parties, rather than enforceable rights over the assets. In Vietnam, guarantees are also referred to as a type of security.

Mortgage

The key characteristic of a mortgage in Vietnam is that the mortgagor is not required to part with possession of the mortgaged property (though the parties may agree that a third party holds the mortgaged property for the term of the mortgage).

A mortgage can be granted over "revolving" or "fluctuating" property (e.g. security over interchangeable stock that can be replaced from time to time) and may also be granted over certain types of future property.

A mortgage is the only type of security that can be granted over immoveable assets, such as land or assets attached to land.

Pledge

Under a pledge, in contrast to a mortgage, the pledgor is required to pass possession of the pledged property

to the pledgee, or a third party nominated by the pledgee, for the term of the pledge. As possession is transferred to the pledgee, this often makes enforcement over the secured assets an easier process as a practical matter.

A pledge may not be granted over land or assets attached to land.

Third party security

Security for the obligations owed by the borrower or debtor may also be provided by a third party. It is common in Vietnam to require guarantees or other forms of security from shareholders, holding companies or related group companies, which may include pledges or mortgages over their assets.

Registration requirements

The creation of security over certain types of assets such as land use rights, assets attached to land, ships and aircraft, requires registration for the security to be legally binding and effective.

However, other types of security do not need to be registered in order to be effective as between the security provider and the secured party, but must be registered in order to be legally binding vis-à-vis third parties (including other creditors of the borrower) and in order to confer priority.

Security over most types of assets is registrable with the National Registration Agency for Security Transactions ("**NRAST**"), established under the Ministry of Justice. Security over land must be registered with the relevant Department of Natural Resources and Environment ("**DONRE**") at its Land Use Rights Registration Centre. Other types of assets with their own central register of ownership may have their own security registration requirements (e.g. the registration of mortgages for ships with the Vietnam National Maritime Bureau and for aircraft with the Civil Aviation Authority).

Notarisation requirements

Security over land use rights and assets attached to land (including future real property) must be notarised

by a public notary in order to be effective. Notarisation is not required for other types of security.

Typical security package

Vietnamese law does not recognise a form of security equivalent to an English law style fixed and floating charge. It is therefore necessary and market practice to take security over different classes of assets separately. A typical comprehensive Vietnamese onshore security package may include the following:

Land use rights and assets attached to land

A mortgage may be taken over land use rights and assets attached to land. Under the Law on Land, the mortgagor must have paid land rent or land use fees (as applicable) upfront for the use of the land over the entire term of the land use right, in order to grant this security, but this constraint does not apply to granting a mortgage over the assets attached to the land.

In addition, a mortgage over these immovable assets may only be secured in favour of credit institutions authorised to operate in Vietnam.

This restriction gives rise to complications in offshore financings, where members of a syndicate include foreign banks. While we have seen certain solutions being structured to overcome this restriction, their validity has not been tested or confirmed by Vietnamese courts. Structuring an offshore financing to include security over land use rights and assets attached to land must therefore be considered carefully with your legal advisor.

Physical movable assets

Security on physical moveable assets should be taken by way of mortgage if the mortgagor expects to continue to use the assets (or if they will fluctuate over the term of the credit). Pledges may otherwise be given over identified assets that are expected to be "blocked" for the term of the credit, assuming the intention is to transfer possession to the secured party.

Bank accounts

Bank accounts may be secured by way of a mortgage or a pledge. If the security provider is to continue to have control over the bank account a mortgage should be taken. If the intention is to secure a specific amount to be held to the credit of an account, the security can be documented as a pledge.

Escrow arrangements are also frequently used in Vietnam.

Shares or capital contributions

Shares in a joint stock company or capital contribution in a limited liability company should ideally be secured by way of a pledge, perfected through the deposit of the physical share or capital contribution certificates with the pledgee or, where no certificates have been issued, by way of registration with the issuer or registrar of the shares or the capital contribution. Although the pledgee takes possession of the share/capital contribution certificates, usually the pledgor is still contractually entitled to continue to exercise voting rights and other rights, including the right to receive dividends and other distributions, in connection with the pledged shares until a default occurs, (subject to appropriate controls, limitations and negative covenants).

Securities

Additional requirements apply where the pledged securities are registered and deposited at the Vietnamese Securities Depository ("VSD"). Pledges of these securities must be registered with VSD and will only be effective after the book entry transfer of the relevant secured securities from the securities trading account of the pledgor to the pledged securities account of the pledgee. Following the transfer the securities will be "frozen" to prevent further trading.

Mortgage of receivables

Vietnamese law permits mortgages over certain contractual receivables, including debts, contractual property rights, and insurance policies (and their proceeds).

Intellectual property

Intellectual property rights can generally be used as collateral, although certain limitations may apply to moral rights of copyrights holders that may not be transferred.

Security regime for public-private-partnership ("PPP") projects

PPP project sponsors and project companies can grant security over project assets, land use rights and rights to operate the project to credit institutions authorised to operate in Vietnam under general legal principles. The term of the security cannot exceed the concession term of the project. Furthermore, the mortgage cannot affect the objectives, scale, technical standards, schedule and other terms and conditions of the project contract.

Mortgage of land use rights in PPP projects

In PPP project financings, granting a mortgage over land use rights can be complicated. This is due to a requirement under the Law on Land that to grant a mortgage over land use rights, the mortgagor must have paid land rent or land use fees (as applicable) upfront for the use of the land over the entire term of the land use right. Under Decree 15, project companies are exempt from the payment of land rent/land use fees or are entitled to reduced land rent/land use fees in accordance with the land law, which casts uncertainty on their ability to grant security over such assets.

Lenders' step-in right in PPP projects and direct agreements

Lenders' "step-in-rights", or the rights of the lender or a party appointed by the lender to take over the contractual rights and obligations of the project company in certain default scenarios, is not a defined type of security under Vietnam security regulations or the Civil Code. However, such step-in rights are clearly recognised by the PPP regulations of Vietnam (including Decree 15), and they have been included in practice in most foreign invested Build-Operate-Transfer projects. Decree 15 also expressly recognises the concept of consent or direct agreements between the lenders and parties to the project contract. These direct agreements ensure all relevant parties recognise the step-in rights, and are key to their perfection.

Real estate developments and residential property

Residential property may be mortgaged by (i) the developers to credit institutions to raise capital for their construction projects; or (ii) the buyers of the individual residential units, after signing a property sales contract, for financing the purchase of their residential unit. However, both mortgages over a single residential unit cannot coexist.

In order to be able to sell residential units, the developer must (i) release its mortgage over the relevant unit and (ii) have received a written certificate from the Department of Construction of the relevant province that the residential units has fulfilled the regulatory conditions for sale on the market.

Security agency

Circular 42 now specifically provides that the members of a syndicated loan may appoint one of their members as a security agent to manage and realise the security. However, this role is not further developed under Vietnamese regulations and, as the concept of a "trust" does not exist under Vietnamese

law, the security representative responsibilities, particularly in respect of the proceeds of enforcing security, are mainly guided by contracts. Circular 42 does not resolve other issues in connection with security agency in Vietnam (such as whether the security agent can enter into security documents on behalf of a potentially changeable syndicate of lenders or in relation to land use rights and assets attached to the land where there are foreign members of a syndicate).

Enforcement of security

General principles

The method for enforcing security is largely determined by the agreement between the parties as set out in the security agreement. The security may be enforced when the mortgagor/pledgor fails to perform its obligations when they fall due or otherwise as agreed in the security agreement. For security transactions that are required to be registered in order to be effective (such as land and immovable assets, aircraft and ships), notice must be given to the relevant registration authority. Where third parties also have security interests in the property to be enforced, the secured party that intends to enforce the security must give notice to such third parties.

The security may be enforced by way of (i) direct sale of the property by the mortgagee/pledgee, (ii) auction of the property, (iii) the mortgagee/pledgee acquiring the ownership of the secured property (subject to certain restriction, in particular where foreign lenders are concerned), and (iv) other agreed methods for enforcing the security.

In practice, enforcing a mortgage may be more difficult than enforcing a pledge as the mortgagor retains possession. Difficulties should also be expected where the local enforcement agencies or the courts need to be involved.

Immovable property and receivables

The newly effective Joint Circular 16 provides useful guidance and reinforces creditor rights on enforcing security over some specific types of assets, including real estate and immovable property and receivables. Essentially, the new rules make it easier for the security holder to directly receive secured debt receivables from third parties and to transfer its title in future real property directly to a buyer. In general terms, it lifts certain administrative barriers that defaulting creditors used to be able to rely on to obstruct enforcement, most specifically the apparent requirement for borrower consent for the transfer of the secured property. How the new regulation is

implemented in practice remains to be seen and will likely not be consistent throughout the jurisdiction.

Capital contributions

The enforcement of security over capital contributions in a limited liability company can be cumbersome. The other members of that limited liability company must waive their pre-emption rights in respect of that capital contribution (and although it is common practice to obtain a waiver of the pre-emption rights from the other members at the time of the creation of the security and as a condition to the disbursement of financing, it is not clear that such a prior waiver would be upheld in court).

In addition, the business registration documentation of the relevant company will require amendment on the transfer of the equity stake to the security holder or its nominee. This may be more akin to a regulatory approval, adding further uncertainty.

Securities

The regulations relating to the creation and enforcement of security over securities deposited at the Vietnam Securities Depository (VSD) have recently changed. There remains some uncertainty in practice over whether borrower consent (through the execution of a release form) is required to transfer mortgaged or pledged securities from the secured account to the mortgagee's/pledgee's trading account and both the VSD and the securities companies implementing the transactions may take a conservative view.

The contractual arrangements in relation to any such security should be extremely clear to mitigate against uncertainty relating to borrower cooperation in an enforcement scenario, and a number of practical mechanisms may be suggested.

Shares/capital contributions – the foreign ownership caps

The foreign ownership caps (in case the mortgagee is a foreign entity) must also be taken into account if business lines of the relevant company (including both joint stock companies and limited liability companies) include businesses that restrict foreign investors, or if the company is a public company subject to the 49% foreign ownership cap.

Vietnam's legal system is still developing and, in some respects, lacks the certainty of more developed legal jurisdictions. Actual instances of enforcement of complex and wide ranging security packages in Vietnam are rare and no matter how robust the security structure may be, proceeding to enforcement

proceedings is something that should be considered carefully.

Annex – Major laws and regulations governing secured transactions in Vietnam

- Law No. 33/2005/QH11 of the National Assembly dated 14 June 2005 adopting the Civil Code of Vietnam (“**Civil Code**”)
- Law on Land No. 45/2013/QH13 of the National Assembly dated 29 November 2013 (“**Law on Land**”)
- Decree No. 163/2006/ND-CP of the Government dated 29 December 2006 on security transactions as amended by Decree No. 83/2010/ND-CP dated 23 July 2010 and Decree No. 11/2012/ND-CP dated 22 February 2012 (“**Decree 163**”)
- Circular No. 05/2011/TT-BTP of the Ministry of Justice dated 16 February 2011 guiding the registration of and provision of information about security transactions and contracts, and notification of assets attached to enforce a judgement directly, by post, fax or email at registration centres of the National Office for Registration of Security Transactions under the Ministry of Justice as amended by Circular 08/2014/TT-BTP dated 26 February 2014 (“**Circular 05**”)
- Decree 15/2015/ND-CP dated 14 February 2015 of the Government on public-private-partnership investment form (“**Decree 15**”)
- Circular 42/2011/TT-NHNN by the State Bank of Vietnam dated 15 December 2011 regulating the provision of co-financing for clients by credit institutions (“**Circular 42**”)
- Joint Circular 16/2014/TTLT-BTP-BTNMT of Ministry of Justice and Ministry of Natural Resources and Environment dated 6 June 2014 on realisation of collateral (“**Joint Circular 16**”)
- Joint Circular 20/2011/TTLT-BTP-BTNMT of Ministry of Justice and Ministry of Natural Resources and Environment dated 18 November 2011 on registration of mortgage of land use rights and assets attached to land (“**Joint Circular 20**”)
- Joint Circular 01/2014/TTLT-NHNN-BXD-BTP-BTNMT of State Bank of Vietnam, Ministry of Construction, Ministry of Justice and Ministry of Natural Resources and Environment dated 25 April 2014 on mortgage of future residential property pursuant to Decree 71/2010/ND-CP of the Government dated 23 June 2010 providing

guidance on implementation of Law on Housing (“**Joint Circular 01**”)

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