

Newsletter

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The Business Security Act: Financiers May Finally Find Closure

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Thanks to the Ministerial Regulation of the Ministry of Finance dated 30 November 2016 (the "**MoF Regulation**"), the list of entities eligible to be security recipients under the Business Security Act (the "**BSA**") which came into force in July 2016 will be broadened to include a bondholders' representative (also referred to as a bond trustee), who will act for and on behalf of all bondholders under the Securities and Exchange Act B.E. 2535 (as amended) (the "**Securities and Exchange Act**"), among others.¹ We are of the view that this extension to include the bondholders' representative as an eligible security recipient will yield tremendous benefits to traditional financing financiers, in particular, lenders.

This article aims to discuss the positive aspects of the utilization of a bond financing, which is a widely-recognized capital market product, to optimize the privileges and protections available under the BSA.

Illustrations: Problems at Hand

In the pre-BSA era, creating security interests over certain categories of assets to secure debts under Thai law faces several controversial issues and uncertainties. Legal requirements make it impractical from the business perspective to establish security over debtors' assets. Those problematic categories include:

- **Pledge over cash deposits** Delivery of pledged property, an important element to the perfection, may be difficult to establish due to the nature of cash deposits.² Current practices involve lenders requesting borrowers or security providers to physically surrender the passbooks evidencing the cash deposits in hopes that this will satisfy the requirement to physically deliver the pledged property.³

¹ The additional eligible entities under the MoF Regulation are, namely, (a) a special purpose company established for the purpose of securitization; (b) a trustee in the name of a trust under the law on trusts in capital market transactions; (c) a securities company, an asset management company and a bondholders' representative (bond trustee) under the law on securities and exchange; (d) a juristic person conducting futures trading under the law on futures trading; (e) an asset management company under the law on asset management companies and (f) a juristic person having the objective of operating factoring business.

² To date, there is no confirmation from the Supreme Courts of Thailand that a pledge over cash deposits conveys security interest in favor of the pledgee. Lenders are running a great risk in granting loans secured by the pledge over cash deposits.

³ This practice is counter-productive as it prevents borrowers and security providers from managing the funds standing in the pledged bank accounts. In



- **Unregistered machinery** Before machinery is registered with the Central Machinery Registration Office, traditional financing lenders can only accept the only security interest available: a pledge. However, taking the possession and maintain the pledge of machinery are burdensome. Lenders may also find it difficult to determine a suitable third party to take possession of the pledged machinery in their stead.
- **Assignment agreements** When there are no other security interests available, lenders sometimes resort to assignment of contractual rights of debtors. However, assignment agreements do not contribute as a valuable part of a security package for the lenders. This is because assignments under Thai law are merely contractual arrangements and do not create security interest over the assigned contracts. Assignees will not be recognized as secured creditors under the Bankruptcy Act B.E. 2483 (as amended) (the "**Bankruptcy Act**").⁴

How Can the BSA Come to Rescue?

One of the key features of the BSA is that security providers are entitled to retain possession and use of collateral assets. This has truly opened a new avenue for borrowers and security providers as they can fully utilize the collateral assets while such collateral assets are being subject to security in favor of the lenders. In practice, security recipients may restrict dealings, disposals or creation of security interest over the collateral assets to preserve the value of its security.

After the promulgation of the BSA, new categories of assets, which were hitherto not available as part of the security package, are enterprises, inventories and intellectual property.⁵ These alternative categories of assets allow borrowers and security providers to derive additional value from their existing assets, enhance their opportunity to access additional funding sources and achieve better terms of financing from financiers.

Financiers as security recipients under the BSA will be recognized as secured creditors under the Bankruptcy Act. Thus, security arrangements under the BSA should alleviate the uncertainties and obstacles that financiers of traditional financing have experienced under the existing regime of security arrangements prior to the promulgation of the BSA.

addition, it is becoming obsolete as Thailand is entering into the digital economy and passbooks are likened to floppy-A disks.

⁴ Put differently, the rights of lenders of traditional financing as assignees over the assigned contracts will be the same as the rights of other unsecured creditors of borrowers.

⁵ Pursuant to the BSA, assets which may be used as collateral includes enterprises, right of claim (including claims over cash deposits), movable property (including machinery and inventory), immovable property (in case the security provider directly engages in real estate business), intellectual property and other assets as may be prescribed.



Choice of Instruments

The BSA named financial institutions in Thailand (including branches in Thailand of foreign financial institutions)⁶ as eligible security recipients and empowers the Minister of Finance and the Minister of Commerce to issue ministerial regulations to prescribe additional security recipients. Accordingly, the MoF Regulation extended the definition of security recipients to include, among others, a bondholders' representative under the Securities and Exchange Act.

Therefore, the choice of instruments that may be employed in a financing transaction secured by collateral under the BSA can be either one of traditional financing, i.e. loans, or one of the capital market instruments, i.e. bonds. Further, this opens the door for foreign financial institutions (such as supra-national institutions, development finance institutions (**DFIs**) and export credit agencies (**ECAs**)) to participate in such secured financing.

Examples of BSA-secured financing transactions which has become available for the foreign financial institutions to participate includes:

- **Syndicated bonds** While syndicated or club loans secured by BSA-type collateral leads to discrepancies between security packages that can be offered to lenders in Thailand and overseas (as only Thailand-based lenders are permitted to take BSA-type collateral), syndicated bond financing offers a level playing field for all.
- **Project bonds** By its nature, project financing requires long-term commitments and is dependent on both domestic and international capacity to meet its needs. Diminishing roles of commercial banks and increasing appetite of alternative finance institutions such as DFIs and ECAs for project finance participation also leads to structural changes in the markets. It is therefore paramount to ensure that they are eligible security recipients. As a result, project bonds tick all the boxes. In fact, the tested and tried project bonds have already been competing with traditional loan financing.

We summarize below some interesting features differentiating loan financing and bond financing as follows:

Features	Loans	Bonds
Foreign financial institutions and other institutional investors ⁷ as	No. Foreign financial institutions and other institutional investors	Yes. Foreign financial institutions, including DFIs and ECAs, and

⁶ Financial institutions that are eligible security recipients in accordance with section 7 of the BSA are the financial institutions for the purpose of the Financial Institutions Business Act B.E. 2551 (as amended).

⁷ Institutional investors includes the following:
(i) the Bank of Thailand; (ii) commercial banks; (iii) banks established under specific laws; (iv) finance companies; (v) credit foncier companies; (vi) securities companies; (vii) non-life insurance companies; (viii) life insurance companies; (ix) mutual funds; (x) private funds managed by securities



Features	Loans	Bonds
security recipients under the BSA	(that are not financial institutions in Thailand) are unable to receive security under the BSA if they provide financing in the form of loans. For example, Bank A located in Singapore and Company B intends to provide financing to a Thai borrower. Each of Bank A and Company B is not eligible to be a security recipient under the BSA.	other institutional investors are able to receive security under the BSA if they provide financing in the form of bonds. In such case, a bondholders' representative, which is an eligible security recipients under the BSA, will act for and on behalf of the bondholders (i.e. foreign financial institutions and other institutional investors).
A financier to transfer its rights under financing documents to a third party	Yes. However, the transfer will have to be made by way of an assignment of contract. Under Thai law, an assignment will have to be made in writing between the assignor and the assignee. In order for the assignment to be binding towards the obligor of the assigned contract, either a notice	Yes. A bondholder will be entitled to freely transfer the bonds held by it to any person, subject to any transfer restriction being registered with the Office of the Securities and Exchange Commission of Thailand (the " Office of the SEC "). ⁸ There is no need to amend the security documents every time

companies for investment of investors under (i) to (ix) or (xi) to (xxvi) or high net worth investors; (xi) provident funds; (xii) the Government Pension Fund; (xiii) the Social Security Fund; (xiv) the National Saving Fund; (xv) the Financial Institution Development Fund; (xvi) derivatives business operators under the law on derivatives; (xvii) futures business operators under the law on agricultural futures trading; (xviii) international financial institutions; (xix) the Deposit Protection Agency; (xx) Stock Exchange of Thailand; (xxi) juristic persons in the category of statutory corporations; (xxii) juristic persons whose shares are held by person under (i) to (xxi), in aggregate, exceeding seventy five percent of all shares with voting rights; (xxiii) foreign investors having similar characteristics to persons under (i) to (xxii); (xxiv) fund manager whose name is registered as qualified fund manager under the Notification of the Office of the SEC concerning rules, conditions and procedures for appointing and performing of duty of fund manager; (xxv) derivatives fund manager whose name is registered as qualified derivatives fund manager under the Notification of the Office of the SEC concerning rules, conditions and procedures for appointing and performing of duty of derivatives fund manager; (xxvi) any other investors as specified by the SEC Office.

⁸ Transfer restriction registration requirement may or may not be applicable, and the requirement may differ, depending on the type of offering; public offering or private placement.



Features	Loans	Bonds
	<p>of assignment will have to be delivered to the obligor or a consent in writing will have to be obtained from the obligor is required.</p> <p>In addition, security documents will have to be amended to reflect a change in the financier. This will require cooperation of all parties to the security documents. More importantly, this exercise may entail official fees for certain types of assets. For instance, a change in the land and building mortgagee will entail a fee of 1 percent of the mortgaged value with a cap of Baht 200,000 and a change in a machinery mortgagee will entail a fee of 0.1 percent of the mortgaged value with a cap of Baht 100,000.</p>	<p>there is a change in bondholders. The security documents will be entered into between the issuer/security providers and the bondholders' representative, who will act for and on behalf of all bondholders as the security recipient. The bondholders will be able to enjoy the unfettered rights over the security held by the bondholders' representative. Also, changes in bondholders will not entail any official fees.</p>
<p>Disclosure requirement under the Securities and Exchange Act</p>	<p>No. Loans are not security but are contractual arrangements between lenders and borrowers. Borrowers are not subject to the Securities and Exchange Act. An information memorandum describing a project as part of the borrower's application to obtain financing is not considered a prospectus under the Securities and Exchange Act and thus,</p>	<p>Yes. As bonds constitute securities, the issuer of the bonds will be subject to the Securities and Exchange Act. Unless the transaction is exempted from the filing requirements, the issuer will have to submit a registration statement and draft prospectus with the Office of the SEC. The issuer will also be subject to filing fees prescribed by the Office of the SEC.⁹ With a view</p>

⁹ Filing fees differ depending on the type of offering. For offerings of long-term Baht bonds by a Thai issuer to investors in Thailand, no filing fee if offered on a private placement basis (not more than 10 bondholders during any 4-month period); a Baht 50,000 filing fee if offered to institutional and high-net worth investors and 0.01 percent of the principal amount of bonds with a cap at Baht



Features	Loans	Bonds
	<p>the borrower will not be held liable for any misstatement or omission of any material facts disclosed in the information memorandum under the Securities and Exchange Act.</p>	<p>of protecting the bondholders, issuers also will be held liable for any misstatement or omission of any material facts disclosed in the prospectus under the Securities and Exchange Act.</p>
<p>Third party appointment</p>	<p>No. However, generally in a syndicated loan or a club loan, lenders usually appoint a security agent to manage the security on behalf of all lenders. The ability of the security agent to hold the security on behalf of the lenders may be limited, however, Thai law does not recognize the concept of trust (whereby property may be held by one party for the benefit of another). In practice, therefore, each of the lenders and the security agent will have to take collateral assets as security under its own name. For example, with respect to mortgages, all lenders and the security agent will be registered as mortgagees, as opposed to only as the security agent. In case of any change in the mortgagees, a new registration to effect such change will have to be made and each registration is subject to official fees.</p>	<p>Yes. The issuer is required to appoint a bondholders' representative to hold the security for and on behalf of all bondholders. The ability of the bondholders to manage the security is recognized under the Securities and Exchange Act, and thus is fully enforceable. In case of a mortgage registration, only the bondholders' representative will be registered as the mortgagee. Therefore, a fresh registration is not required every time there is a change in bondholders.</p>

500,000 if offered to retail investors. For offerings of foreign currency-denominated bonds to investors outside Thailand, no filing fee, but there is an application fee of Baht 10,000.



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In conclusion, bond financing allows financiers to reap many benefits from the new types of security interests available under the BSA, especially in comparison to traditional loan financing. Foreign financial institutions and many categories of investors can participate in a financing transaction whilst being entitled to receive the same security arrangements under the BSA as financial institutions in Thailand involved with the same transaction. Bond financing is a particularly appealing option for borrowers who require financing in foreign currencies and can offer alternative security interests under the BSA.

Also, any change of financiers can be executed in a relatively hassle-free manner in bond financing subject to the transfer restriction registered with the Office of the SEC. Any transfer of a loan by a lender will need to be in the form of an assignment, which may be costly and time consuming as the assignment must be done in writing. The relevant security documents will have to be amended each time, and associated official fees may be significant. On the contrary, a bondholder can freely transfer the bond without the requirement to constantly amend the security documents.

We envisage that bond financing, with its ability to accommodate different types of security interests under the BSA, may become an attractive alternative to traditional financing going forward.