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Cyprus: Law & Practice

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CYPRUS

Law and Practice

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Contents

1. Loan Market Panorama

1.1 Impact of the Regulatory Environment and Economic Cycles

The Cypriot economy has seen a steady growth in recent years (at least pre-COVID-19) and this is reflected in the improvement of Cyprus' credit rating. This in turn has aided banks, financial institutions and private companies to raise capital, uphold strong capital positions and reduce the amount of non-performing loans (NPLs). Since the 2013 banking crisis, the banking sector had to restructure the way it functions, by refining and strengthening its capital and investing in its corporate governance. All domestic banks have been under the supervision of the European Central Bank (ECB) and gone through various stringent assessments that have successfully created more robust and steady foundations.

A popular trend in the market (pre-COVID-19) has been the consolidation of businesses via mergers and acquisitions, including in the financial sector with larger banks acquiring smaller ones, whilst particular divisions handling the management of NPLs have improved lending conditions in general.

Reforms, New Laws and Current Trends

Reforms of the island's legal and judicial structure include the new state scheme (ESTIA) which aims to support vulnerable borrowers who are encountering financial problems repaying their loans backed by main residences.

The new Securitisation of Credit Facilities or Other Forms of Claims or Exposures Law (88(I)/2018) (the "Securitisation Law"), passed in 2018, enables a lender to refinance a set of loans, exposures or receivables by transforming them into tradeable securities accessible to investors. Its goal is to ease the minor loan market, and hopefully, ultimately, reduce the number of NPLs.

The 2013 banking crisis made obtaining loans from banks more challenging due to increasingly stringent procedures and checks. Even though new lending increased in 2019 (mainly to non- financial corporations) the private sector continued to rely on internal resources and foreign funding, as new lending from domestic banks was still constrained by large proportions of non-performing loans, elevated debt and tighter credit standards.

1.2 Impact of the COVID-19 Pandemic

The effects of COVID-19 have been felt since early 2020 due to the lockdowns and other restrictions put in place to try and control the spread of the pandemic, both in Cyprus and internationally. All these have unavoidably had an adverse effect on the Cypriot economy. Although the rising trend of new lending of 2019 will continue, albeit for different reasons, as banking institutions (in their assigned role as a vehicle of the government to assist and revive the economy) implement the measures discussed below and grant loans to keep businesses afloat, COVID-19 has driven the percentage of gross public debt to around 122%, the highest level since 2010.

As part of a budgetary policy response in the wake of COVID-19, Cyprus introduced its "Stability Programme 2022–2025". The aim of the Stability Programme is to provide emergency relief and to support the Cyprus economy under the present exceptional economic crisis that has arisen as a result of COVID-19. One of the measures which was introduced by the Stability Programme, was the suspension of loan instalments for enhancing liquidity enabling a payment moratorium for nine months to apply to

credit-worthy borrowers that are affected by the restrictive measures imposed by the authorities.

These temporary measures applied for a limited period from 30 March 2020 to 31 December 2020. The moratorium covered capital, interest and compound interest payments and both physical and legal entities were eligible. An extension of the moratorium beyond 31 December 2020 to 31 December 2021 was not obligatory but remained at the discretion of each banking institution on a case-by-case basis.

Liquidity Aiding Measures

In addition to the above in May 2020, the Cyprus government announced further stimulus measures to "jump-start" the Cypriot economy, impacted by the COVID-19 pandemic, with major input from the European Investment Bank (EIB), in the form of loans worth approximately EUR1.2 billion, along with interest rate subsidies for businesses and housing loans. By utilising the tools provided by the European Union and European financial institutions, the Cyprus government amongst other measures introduced various liquidity aiding measures as follows. The Temporary Framework lasted until the end of December 2021.

Pan-European Guarantee Fund

By participating in the Pan-European Guarantee Fund (established to tackle the adverse economic consequences of the pandemic) and in return for a contribution of EUR32.5 million, Cyprus expected to be allocated EUR300–400 million of direct guarantees from the Fund for the needs of businesses. The Fund was intended to guarantee up to 80% of a bank's indebtedness, to small to medium sized enterprises employing up to 3,000 employees, with the caveat that they must not have laid off staff during the "lockdown" period. The guarantees were intended to encourage the banks to cover working capital shortfalls for businesses which were viable before the onset of COVID-19. The Fund's initial investment period ended on 31 December 2021.

State guarantees

The government will provide an additional EUR500 million of state guarantees to the EIB which, in turn, will advance loans at more favourable interest rates to businesses in the small medium enterprise sector.

The Cyprus Entrepreneurship Fund

The Cyprus Entrepreneurship Fund will be expanded by EUR800 million. Businesses with a maximum of 250 staff will be eligible to apply for a maximum loan of EUR1.5 million, repayable over a period of up to 12 years at interest rates currently ranging from 2.55% to 4.5% depending on the perceived risk of the loan. The Cyprus government will fund 50% of the new money via a loan from the EIB with local lenders providing matching funding with a 50/50 split of the risk between the parties. The deadline for such applications by suitable financial intermediaries is 31 December 2024.

Scheme to subsidise new loan interest rates

A scheme which will subsidise interest rates for new loans taken out between 1 March 2020 and 12 December 2020 (subsequently extended) provided that the maximum interest rate on them does not exceed 4.25%. The subsidy will run for four years and cover loans taken out between 1 March 2020 and 12 December 2020 (subsequently extended) provided that the maximum interest rate on them does not exceed 4.25%. All previously viable businesses adversely impacted by the pandemic will be eligible to participate.

The loans may be used for the purpose of investment or, as working capital, but they cannot be

used to repay existing indebtedness or for the purposes of restructuring a business.

In January 2021, the measures to support the Cypriot economy and employment sector were prolonged. One of these measures included the six-month extension of the interest subsidisation plan for new business loans as well as the interest subsidisation plan for new housing loan mortgages for loans to be approved until 31 December 2021. Additional support schemes and allowances were introduced including the suspension of repayment of capital or interest pursuant to bank loans or credit facilities for certain categories of borrowers.

Fiscal Market 2021–2022

The ongoing global pandemic, worries over possible new pandemics, the Ukrainian war, the possible recession and the ensuing social and political factors have inevitably left their mark on fiscal markets worldwide. In a recent interview, the Governor of the Central Bank encouragingly stated that the banking sector of Cyprus faces the effects of the Russian invasion of Ukraine from a financially sound position. He explained that the Liquidity Coverage Ratio as of February 2022 is almost double the respective EU average of 175%, adding that more importantly, the first-round effects of the war on the Cyprus banking system do not appear to pose any material threat to the banking sector since the direct links of Cyprus's banking sector with Russia and Ukraine are limited and not material.

He further stated that as of December 2021, the total assets that are loans and deposits from the two countries amounted to just 0.8% of total loans and 4.7% of total deposits, respectively.

In addition, the Central Bank of Cyprus (CBC) has advised that the Cyprus banking sector is continuing to provide credit to viable businesses and households increasing the total new lending to households and businesses.

Despite the lowering of the 2022 GDP growth forecast, a weaker economy and uncertainty about the path of inflation, the Cypriot banking outlook in the current economic and political climate is still positive.

1.3 The High-Yield Market

As an increasing number of companies battle the economic consequences of COVID-19, their ability to service bond payments is coming under intense scrutiny. Credit spreads have inevitably widened since the pandemic as investors have reallocated from higher risk assets to safer ones resulting in reduced access to bond markets for the few Cyprus-based companies that were involved. Credit rating agencies have also downgraded many companies as more countries have gone into lockdown, hurting all borrowers and creating uncertainty for the financial institutions operating in the Cyprus market.

In addition, the legislation allowing a borrower a moratorium on repayments/debt servicing, has created further uncertainty and, in turn, reluctance by financial institutions to enter into new lending as their risk appetite lessens.

1.4 Alternative Credit Providers

The search for alternative finance has taken on a new urgency following the lockdown and the collapse of the government's efforts to pass the bank-loan guarantee legislation (whereby security for loan repayment would be guaranteed by the government and bank institutions), leaving thousands of businesses which are unable to provide sufficient security to the banks or convince them of their viability during the pandemic or in its aftermath.

In the post-COVID-19 environment, the search for alternative financing has grown. Turning to the stock market as a means of raising capital, aside from being a lengthy process, is not a favourable option in Cyprus due to liquidity and small market restraints. Thus, a number of SMEs are considering or tapping into factoring or invoice discounting and private lending. There has been a sharp increase in requests and inquiries in this area.

1.5 Banking and Finance Techniques

The Cypriot banking crisis of 2013 and the subsequent reforms in the banking sector, aimed at addressing the challenges facing the banking system, have resulted in the banks being very cautious towards new lending. Banks now tend to seek to not only over-collateralise their exposure but to seek increasing levels of comfort regarding the underlying repayment ability. This in turn has meant that the application approval rate has fallen and an increase in turnaround times (and corresponding overheads). The management and sale of NPLs has remained a topic of ongoing discussion in the market with some progress in respect of this.

Whilst the measures are meant to reassure investors, this has not been reflected in stock exchange pricing trends, with banking stocks continuing to fall.

Aside from this, there has not been any other significant alteration in banking and finance techniques to date. Having said this, in view of the current support schemes offered in response to COVID-19 (see **1.2 Impact of the COVID-19 Pandemic**), the requirements of the banks will need to be adjusted with regard to the particular grant/scheme provided to the borrower.

1.6 Legal, Tax, Regulatory or Other Developments

In order to support the measures referred to in **1.2 Impact of the COVID-19 Pandemic**, various pieces of legislation have been passed, including the Law on Taking Emergency Measures by Financial Institutions and Supervisory Authorities Law (33(I)/2020). The latter authorises the suspension of loan repayments until 31 December 2020.

1.7 Developments in Environmental, Social and Governance (ESG) or Sustainability Lending

The emerging sector of environmental, social, and governance (ESG) investments and interest in sustainable lending is a trending topic, albeit one that does not seem to be a primary driver for or element in investments in Cyprus yet (even if all or some of the aforesaid elements are part of a review of a prospective investment). Having said this, there is a build-up of momentum due to the recently announced commitment of the USA to achieve neutrality targets and the EU Sustainable Finance Disclosure Regulation (SFDR), which came into effect earlier this year and the EU Non-Financial Reporting Regulation (NFRR) of 2018.

The Disclosure Regulation has imposed harmonised transparency and disclosure requirements on financial market participants and financial advisers. Companies within its ambit must contemplate how sustainability risks are merged into the investment decision-making process as well as how remuneration is aligned with a company's sustainability goals. Therefore, the SFDR is expected to affect a majority of the financial services industry in Cyprus. The Cyprus Securities and Exchange Commission (CySEC) has confirmed that supervised entities need to fully comply with the SFDR disclosure obliga-

tions and with their ESG commitments as they will be closely monitored.

CySEC has recently reinstated its mission to nurture compliance with sustainable finance standards.

As a result, the discussion around ESG in Cyprus has increased significantly, with the financial regulators, financial services organisations, banks and investment funds preparing to conform with the above EU directives, in addition to applying effective procedures, but such interest is primarily limited to larger companies (mostly listed) and banks.

As an example, one of the larger local banks has already received an "A" rating from the Morgan Stanley Capital International (MSCI), the global benchmark on ESG.

2. Authorisation

2.1 Authorisation to Provide Financing to a Company

Under the Business of Credit Institutions Law of 1997 (Law No 66(I)/1997, as amended) (Credit Business Law), banks require a licence to conduct banking services.

The application for obtaining a banking licence should be made in writing by or on behalf of the applicant to the CBC and no application fee is payable. Such application form must be accompanied by a business plan describing the types of activities envisioned and the organisational framework intended. In addition, relevant questionnaires which are issued by the CBC for the licensing of banks in the Republic of Cyprus need to be appropriately filled in and, in general, the CBC can request additional details prior to deciding whether to approve the application.

In order to be granted a banking business, the applicant must be either a legal person set up in Cyprus under the Companies Law, Chapter 113 (the "Companies Law") as amended or a credit institution established and approved in its relevant country. If the applicant is not an existing EU credit institution, it must have initial capital of at least EUR5 million (meeting the capital requirements as set out in EU Regulation 575/2013 on prudential requirements for credit institutions and investment firms), although there may be specific situations where the CBC will consider allowing for a smaller initial capital.

Although the process is managed by the CBC, the ultimate decision-making powers on whether to grant relevant authorisation vest with the ECB.

EU Credit Institutions and Non-banks

The aforementioned criteria do not apply to EU credit institutions wishing to establish a branch in Cyprus, since credit institutions licensed by competent authorities of another EU member state may, under the provisions of Section 10A of the Credit Business Law, establish a branch in Cyprus without the need to obtain a banking business licence from the CBC.

With regard to non-banks, the Investment Services and the Exercise of Investment Activities, the operation of Regulated Markets Law and other related matters (87 (I)/2017, as amended) provides guidance as to the corporations and institutions capable of providing financial services. Such non-banks include any licensed Cyprus Investment Firms (CIFs), which require the prior approval and authorisation of CySEC. The requirements for a CIF depend on the spe-

cific type of investment and financial services provided by such company.

An investment firm originating from another member state or a third country is able to provide such services in Cyprus through its branch provided it is authorised and overseen by a competent authority in that member state or third country and it complies with all the disclosure requirements of CySEC.

Finally, it is noted that private lending (eg, peer-to-peer or similar) or cross-border lending does not fall within the above framework but under general principles of commercial law.

3. Structuring and Documentation Considerations

3.1 Restrictions on Foreign Lenders Granting Loans

Foreign lenders are not restricted from granting loans provided doing so is compliant with the laws of their own jurisdiction and this does not amount to doing business in Cyprus as a financial institution (ie, falls under the definition of offering banking services). The latter generally means retail banking as opposed to the provision of one-off financing.

3.2 Restrictions on Foreign Lenders Granting Security

Borrowers are not restricted from granting security over any type of property, or guarantees to foreign lenders, nor providing from foreign subsidiaries of the borrower provided there are no such restrictions in their constituent documents, the Companies Law or other provisions (such as AML regulations).

3.3 Restrictions and Controls on Foreign Currency Exchange

There are no foreign currency exchange controls or restrictions as Cyprus is a euro area member state. Local borrowers are not restricted from borrowing in any foreign currency. Temporary restrictive measures were only imposed under the Enforcement of Restrictive Measures on Transactions in case of Emergency Law No 12(I) of 2013 for a limited period of time. Further, the Movement of Capital Law No 115(I) of 2003 ensures that there are no restrictions on the movement of capital, including payments to and from residents of Cyprus and residents of the EU or third countries. See **3.4 Restrictions on the Borrower's Use of Proceeds**.

3.4 Restrictions on the Borrower's Use of Proceeds

Obviously, the proceeds must be used for legitimate purposes and subject to any restrictions imposed by the financing documents themselves. The effect of a borrower acting contrary to the approved purpose may, depending on the circumstances, cause the contract to be void by reason of the objects being unlawful in part, or voidable at the option of the lender whose consent was caused by fraud or misrepresentation, under the Cyprus Contract Law, Chapter 149 (the "Contract Law"). In addition, the use of such proceeds must always comply with the scope of activities of the borrower as these are stated in its memorandum of association, and must comply with general principles of contract law as well as specific restrictions/prohibitions that may exist under relevant applicable law.

Further, Cyprus is a full member of the European Union and the United Nations, and applies, enforces and implements any international sanctions by a relevant decision or resolution adopted by the UN Security Council, and restrictive

measures adopted by the Council of the EU via relevant decisions and regulations, within the framework of Common Foreign and Security Policy. Therefore, the use of proceeds to make or be part of any arrangement to provide loans or credit to, or enter into any transactions or dealings with certain financial instruments with, any legal person, entity or body on any such sanctions list (or any legal person, entity or body majority-owned by such sanctioned person, or acting on behalf of such sanctioned person) is prohibited.

3.5 Agent and Trust Concepts

Both agent and the trust concepts are recognised in Cyprus. Agency law is generally governed by several pieces of legislation, including Sections 142–198 of the Contract Law, which ultimately mirror English common law.

Likewise, trusts are of common law application and the relevant domestic law is the Trustees Law, Chapter 193, as amended, and the International Trusts Law of 1992 (No 69(I)/1992), as amended. The general idea of a trust is that it creates a fiduciary relationship where the trustee holds title to a property for the benefit of a third party. Thus, a trust can also be used to hold security over the possessions of debtors on behalf of creditors.

An alternative concept, which falls between the two and is commonly used in financing/banking as well as commercial transactions, is that of the escrow agent, whereby the escrow agent assumes the role of both the trustee and the agent – for both parties – in order to facilitate the conclusion of a transaction.

3.6 Loan Transfer Mechanisms

The is no statutory mechanism. The loan documentation will usually provide that the lender may freely assign its rights and obligations to a new lender; the borrower will not usually be allowed to novate its obligations without the prior express or written consent of the lender.

With respect to securities granted to the original lender, these may be either released with the simultaneous execution of termination agreements with respect to the existing security agreements between the borrower and the original lender, and the new security agreements between the borrower and the new lender as secured party (or a tripartite agreement between the borrower, the original lender and the new lender), or transferred without release in favour of the new lender. The process is regulated by general principles of law and the Contracts Law.

3.7 Debt Buy-Back

There are no general statutory restrictions, it is a matter of commercial terms (existence or negotiation) and capacity under the constituent documents of the parties involved. There may be instances of specific restrictions (such as when the buy-back by an affiliate amounts to financial assistance) and therefore each case needs to be examined on its particular facts.

3.8 Public Acquisition Finance

With respect to public takeover bids pursuant to the Public Takeover Bids Law 41 (I) of 2007 (as amended), for the acquisition of securities of companies (or a squeeze-out or a sell-out) it is possible to offer securities, cash or a combination of both. The consideration must be equal to at least the highest price paid or agreed to be paid for the same securities by the offeror, within 12 months before the bid announcement.

When a bid is made for a cash consideration, the bidding party must, in support of the bid, provide confirmations by (i) its board of directors, and (ii)

one or more credit (or other) institutions with the necessary solvency (determinable by the regulatory authority with respect to public takeover bids, CySEC), that the cash is and will remain available to such institution until the day of payment with respect to the bid. In the absence of such confirmations, CySEC shall reject the takeover bid documents. The public offer documents are mandatorily submitted to the commission and the board of the offeree company, and will be made available to the holders of securities subject to the bid following securing the approval of the commission to publish the same, and is announced in at least two daily newspapers with national circulation.

4. Tax

4.1 Withholding Tax

Repayments of loans to the lender (whether located within or outside Cyprus, including interest repayments), would not be subject to Cyprus withholding tax deductions, as Cyprus does not levy withholding tax on such payments.

4.2 Other Taxes, Duties, Charges or Tax Considerations

All agreements concerning property situated in Cyprus or involving things or acts to be done in Cyprus are subject to stamp duty, the maximum stamp duty payable on a single agreement (usually the loan agreement) being EUR20,000, with all ancillary agreements thereto (such as the security documents) being stamped at EUR2 each. The Commissioner for Stamp duty has discretion to exempt an agreement from stamp duty if the agreement is considered as referring to property which is not situated in Cyprus or is an ancillary agreement relating to transactions taking place outside of Cyprus; however, it is common practice for the Commissioner to impose stamp duty on security agreements if the chargor is located within Cyprus, irrespective of whether the loan facility agreement is entered into between a lender and a borrower, both of whom are incorporated and/or situated outside Cyprus. In such case, the loan facility agreement itself is not subject to stamp duty, however the security agreements are stamped with one applicable stamp duty,and the others if in relation to the same transaction at a fee of EUR2.

Registration of a charge which is registerable with the Cyprus Registrar of Companies is subject to a flat registration fee of EUR640.

4.3 Usury Laws

Usury principles are contained in the Criminal Code, Chapter 154, (the “Criminal Code”) which prohibits the receiving, charging and/or collecting of interest at a higher rate than the interest rate ceiling during the provision of any loan period, except credit institutions. The CBC must calculate the interest rate ceiling every three months and this is then published in the Official Gazette of the Republic of Cyprus.

Usury is punishable upon conviction with a fine not exceeding EUR30,000 and/or imprisonment not exceeding five years. Banking regulations also prohibit the charging of interest on interest (double counting) and general contractual principles render void/unenforceable provisions that are penalty clauses in disguise.

5. Guarantees and Security

5.1 Assets and Forms of Security

Typically, the assets that are used as collateral to lenders are immovable property (real estate), tangible movable property (eg, goods, stock, equipment and ships), financial instruments

such as shares, bonds, receivables, present or future cash and intellectual property. The security usually takes the form of an encumbrance or charge/pledge over the asset depending on its nature.

Where the security is financial collateral, no formalities exist under Section 90 of the Companies Law and the requirements contained in Section 138 of the Contract Law do not apply.

The formalities are outlined in more detail in **5.5 Other Restrictions**.

5.2 Floating Charges or Other Universal or Similar Security Interests

Generally, no restrictions exist on the type of assets over which a security can be fixed unless it is a future asset, in which case any type of security can be granted (including a floating charge), besides a legal mortgage and a pledge. Likewise, any security can be fixed over interchangeable assets, besides a legal mortgage.

5.3 Downstream, Upstream and Cross-Stream Guarantees

It is possible for corporate entities to provide downstream, upstream and cross-stream guarantees as long as the guarantee is in accordance with Section 53 of the Companies Law (financial assistance) and as long as they have the necessary corporate power to do so. Section 53 provides whitewash provisions regarding unlawful financial assistance of private companies. Specifically, the provision of direct or indirect financial assistance by a private company for acquisition of its own shares or of the shares of its holding company is not unlawful in cases where:

- such private company is not a subsidiary of any public company; and
- the relevant transaction is approved by the general meeting of the company by a resolution passed by a majority of 90% of all the issued shares of the company.

It is important to highlight that the general prohibition on the provision of financial assistance by a public company for acquisition of its own shares still exists.

Further, it should be noted that the whitewash provisions do not affect the obligation to comply with any other legal obligations (eg, when acting as a guarantor, the directors of a company owe a duty to their company to act in good faith for the benefit of the company). The company's benefit from acting as a guarantor should be established.

5.4 Restrictions on Target

See **5.3 Downstream, Upstream and Cross-Stream Guarantees**.

5.5 Other Restrictions

Security

Charges (fixed or floating)

This is a common form of security taken over movable property. If the chargor, is a Cyprus legal entity, then the charge must be registered with the Registrar of Companies (RoC) within the given statutory timeframe, on the prescribed HE24 form and accompanied with the relevant fee. If a charge is not registered appropriately, it will be invalid against a future liquidator of the legal entity chargor.

Liens

Liens can arise under common law or equitable principles with no formalities being observed, although a contract may explicitly provide for a lien.

Mortgages
This is a common form of security taken over property such as real estate, vessels, ships. The lender obtains a right in rem over the property. If a mortgage is not properly registered with the RoC within the time limit set out by the Companies Law, then the mortgage will be void against a liquidator or creditor of the mortgagor company.

Pledges
A pledge of shares of a Cypriot company is not registrable for perfection purposes. However, if a pledge has been taken over a foreign company's shares by a Cypriot-registered company, then the pledge has to be registered as a charge with the RoC to be perfected and valid against a liquidator of the pledgor. In addition, a pledge can be created over any kind of movable property.

The formalities for a pledge of shares of a Cypriot company, in order to be valid and enforceable according to Section 138 of the Contract Law are:

- it must be in writing, signed by the pledgor and the pledgee, and have at least two witnesses;
- the pledgee must give notice of the pledge to the company whose shares are being pledged;
- a memorandum of the pledge has to be added in the members' register of the company whose shares are being pledged; and
- the company must issue and deliver to the pledgee a certificate executed by the appropriate official of the company confirming the fact of the registration of the pledge in favour of the pledgee.

No formalities are applicable when a security is financial collateral, and the requirements contained in the Contract Law are not relevant.

Guarantee
Usually, a company offers guarantees as security for money owed on behalf of itself or a third party. In order for a company to grant a guarantee, it must have the adequate corporate power to do so and if it does not, the corporate guarantor must show that it will have a corporate benefit in giving the guarantee and that it serves its commercial and business interests. Furthermore, guarantees are usually formed by way of a written agreement and are bound to the contractual principles agreed between the parties themselves.

5.6 Release of Typical Forms of Security
A security is usually released via an agreement between the relevant parties. If, however, a security is registered as a charge under the Companies Law, then the RoC may release the security, either in whole or partial repayment of the secured debt. Filing the release with the RoC, is a formality and it does not affect the validity of release.

Releasing a legal mortgage over immovable property, occurs when the mortgagor and the mortgagee present to the district lands office with the necessary documentation, according to the Transfer and Mortgages Law. In case a mortgagee does not release the mortgage, even after the discharge of secured obligations, then a court order to cancel the mortgage can be obtained by the mortgagor.

Procedures for the termination of a share pledge are specified in the pledge agreement and usually occur either when:

- the secured obligations have been discharged in full;
- via written agreement of the pledgee and the pledgor;
- the pledgee has served a termination notice on the pledgor; and
- enforcement of the pledge by the pledgee.

Following termination, the pledgee returns the pledge security documents to the pledgor and the secretary of the company whose shares were pledged is instructed to delete the memorandum of pledge against the pledged shares in the register of members.

5.7 Rules Governing the Priority of Competing Security Interests

Competing Security Interests

The priority of competing security interests is governed by the principles of common law. In general, priority is determined by the time of creation and the type of security interest created. For example, a fixed charge will have priority over a floating charge, and if the security interests are of the same kind (eg, two legal fixed charges) then the earlier security will take priority.

The rules of priority are subject to limitations arising from insolvency laws (see **7.3 The Order Creditors Are Paid on Insolvency**).

Subordination

Various methods of contractual subordination are used in Cyprus to determine which lenders are the first eligible ones to receive interest and repayments, and which ones have first claim, over loan collateral. Generally, the "senior" lender has priority over any other "junior" lender, whose interest is thus "subordinated" and entitled to interest, repayment or the collateral only once the "senior" lender's claim is satisfied in full.

Contractual subordination of debt is common in lending transactions and can be achieved by having a contractual agreement between the senior lender, junior lender and borrower.

Structural subordination is another method used to arrange the priority of debts. This is done by concentrating the senior debt in an active group company, with available assets and directing the junior debt to the parent company.

Priority of shareholders

In the event of insolvency these arrangements will remain effective subject to the mandatory pari passu principle that the priority of creditors on insolvency is determined by whether they are preferential, general or deferred creditors.

Care must be given in the drafting of such arrangements so that they do not run the risk of being considered ineffective if caught by the fraudulent preference provisions of the Companies Law.

Where the same security is provided to different classes of creditors, inter-creditor arrangements are also made between the lenders and the borrower company through an inter-creditor agreement that sets out the terms and conditions of their relationship.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Generally, a secured lender will be in a position to enforce its collateral in the event that the borrower (and/or any other party providing securities for the loan facility arrangement) is in default of their obligations, as will be more specifically set out in the loan facility or security documents.

In the event of a charge and pledge over shares and share certificates, the pledge agreement secures, through pre-delivered title documents, enforcement under specified circumstances without the need for court recourse.

In the event of a floating charge, on a default event the charge will become fixed and crystallise over the secured assets in accordance with the terms of the agreement, enabling the secured lender (or its administrator/receiver) to liquidate the securities in settlement of the amounts due to it. It is noted that in the event of the security provider undergoing a winding up procedure, in general, secured creditors by way of a fixed charge are entitled to enforce their security in settlement of their particular debt which the security provider has failed to pay, in accordance with the enforcement terms of the agreement or document creating the charge. Floating charges, if not crystallised prior to the commencement of the liquidation or subject to the security documentation, rank for payment after liquidation costs and preferential payments, and before other unsecured creditors.

6.2 Foreign Law and Jurisdiction

The Rome I Regulation (EC) No 593/2008 applies in Cyprus and sets out EU-wide rules for deciding the governing law to be applied to contracts in civil and commercial matters, when parties from more than one country are involved, regardless of domicile (Regulation (EU) No 1215/2012 ("Brussels Recast")). The parties to a contract are free to choose the governing law, and the applicable law can be amended, as long as all parties consent to it. Therefore, a choice of foreign law as the governing law of a contract in a security contract shall be recognised as long as it made without duress and is not contrary to the public policies of the Republic of Cyprus. However, when security is taken over immovable property in Cyprus, as well as a pledge of shares in a Cypriot company, domestic law will inevitably apply in order to be valid and enforceable.

Jurisdiction matters are administered by the Brussels Recast which applies again only to civil and commercial matters. The only reason for a judgment passed in an EU member state not to be accepted, is its recognition being challenged, and for that reason, an assertion that such foreign judgment is enforceable is issued once the official and proper review of the related documents have been made.

Applicable and Foreign Jurisdictions

The applicable jurisdiction is usually the one where a defendant is domiciled, irrespective of nationality, and domicile is governed by that member state's law where a matter is brought before its court.

Submission to a foreign jurisdiction would be upheld as long as the jurisdiction clause had been agreed between the contracting parties themselves and specified in the contract. Appearing in the proceedings or serving a defence would also be grounds for submission to a foreign jurisdiction. If a defendant does not want to submit to a specific jurisdiction, the defendant must not contest the case on its merits, they should acknowledge service stating that they intend to dispute the jurisdiction and make a declaration that the specific member state lacks jurisdiction.

The Cypriot courts do acknowledge and uphold state immunity, as long as such immunity is not consensually waived and that a state is not acting under private or commercial capacity.

6.3 A Judgment Given by a Foreign Court

Depending on the country of the foreign court, it is possible for a foreign judgment or arbitral award to be recognised and enforced in the Republic of Cyprus. In order for a judgment to be valid in Cyprus, it must go through the Cypriot courts' registration system, in order to acquire the same status as a judgment from a national court.

Cyprus is party to various multilateral and bilateral international conventions with other countries, which is influential to the recognition and enforcement of foreign judgments. Different procedural mechanisms may be used to recognise and enforce a foreign judgment depending on the nationality of the court issuing the judgment or arbitral award. For example, Cyprus is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958) (the "NY Convention") and although a judgment from New York would be recognised under the Recognition, Enforcement and Execution of Foreign Judgments Law 121(I)/2000, enforcement is not immediate. The law provides procedural requirements to be followed and ultimately sets a hearing where the respondent can object to matters concerning jurisdiction and substance.

When judgments or arbitral awards derive from an EU court, they will be recognised and enforced accordingly with the Brussels Regulation and the recognition under national law will be automatic. A judgment given by another EU member state court can be challenged in respect of its recognition under specific circumstances by the domestic courts, whereas it cannot be challenged in terms of substance. Therefore, Cypriot courts are not in position to review the substance and/or merits of a judgment.

6.4 A Foreign Lender's Ability to Enforce Its Rights

Aside from contractual restrictions specified in the security/loan agreements or specific debtor protection provisions (such as lending to homeowners for first homes), bankruptcy/insolvency may have an impact as well as any court proceedings initiated by other creditors.

7. Bankruptcy and Insolvency

7.1 Company Rescue or Reorganisation Procedures Outside of Insolvency

Corporate reorganisations can take place according to the Companies Law, by way of compromises or arrangements, usually suggested between the company and either its creditors and/or its shareholders. A court application is therefore made either by the company, or any creditor or a shareholder, seeking a court order for a creditors' or shareholders' meeting subject to the voting requirements being met. The compromise or arrangement becomes binding to all persons involved, when the court approves the court order requested.

The examinership concept is aimed at a company when facing possible insolvency, as an attempt to prevent liquidation. With this, the intention is to appoint an examiner, whose duty will be to assess the rescue plan, while the company is placed under the court's protection, and if the rescue plan accompanying the petition is considered viable, then the court will permit the commencement of "rescuing" the company.

In order for the court to appoint an examiner then three conditions must be met:

- the company is, or most likely will be unable to pay its debts;

- no liquidation resolution for the company has been published in the Official Gazette of the Republic of Cyprus; and
- no court order has been issued for the liquidation of the company.

Furthermore, if the court is convinced that there is a plausible chance of the company enduring, with its entire or part of its business of as a going concern, then it will issue an order for examinership. During that time, the company is "protected" and no court action can be taken against the company without specific court sanction.

7.2 Impact of Insolvency Processes

The degree to which a lender's rights of enforcement are affected upon the commencement of insolvency proceedings depends on the kind of security the lender has over the assets of the insolvent entity. Where relevant, a contract can set out insolvency as an event of default whereby termination and enforcement procedures can be triggered as set out in the contract.

If a winding-up order is made or a provisional liquidator has been selected, the (provisional) liquidator takes over all assets and things in action to which the company is or seems to be eligible to.

A secured creditor ought to file with the official receiver, liquidator or guarantor, a preparatory valuation of the secured asset and reach agreement about the valuation. An independent valuer may be appointed if no agreement is reached, regarding the value. The court may also impose a deadline by which all lenders must verify any debts or claims they may have. If the creditors' debts are not evidenced, then they will be omitted from any distribution since the proof will set out whether the creditor is a secured or unsecured creditor.

Any distribution of the company's property, which occurs after the beginning of winding-up by the court, is void, unless the court orders otherwise. Once a winding-up order is issued by the court and a provisional liquidator is selected, no further action or proceeding can be continued or commenced against the company, unless by leave of the court.

7.3 The Order Creditors Are Paid on Insolvency

Creditors' claims are satisfied in accordance with a priority ranking set out in the Bankruptcy Law and in the Companies Law. The order of distribution is as follows.

- The costs of the winding-up.
- The preferential debts, comprising of:
  - (a) government and local taxes and duties due 12 months prior to liquidation and at the date of liquidation;
  - (b) all sums due to employees, including wages, up to one year's accrued holiday pay, deductions from wages (such as provident fund contributions) and compensation for injury;
  - (c) claims of employees who are shareholders or directors – these may not rank as preferential depending on the nature of the shareholding or directorship; and
  - (d) subrogated preferential claims of a person who has advanced funds to pay employees to the extent that the employees' direct preferential claims have been diminished because of the advances.
- Any amount secured by a floating charge.
- The unsecured ordinary creditors.
- Any deferred debts such as sums due to members in respect of dividends declared but not paid.
- Any share capital of the company. Where there are different classes of share capital,

such as preference shares, their respective rankings will be determined by the terms on which they were issued.

Within each category of claim, creditors rank equally and abate in equal proportions if there are insufficient funds to pay them in full (Section 300(3), Companies Law).

Secured creditors are payable out of the proceeds of sale of the assets subject to the charge. If the charge is a floating charge the charge holder ranks behind the preferential creditors. If there is a surplus from the sale of the assets subject to the charge it becomes part of the general pool of assets. If there is a shortfall the creditor concerned will have an unsecured claim for the shortfall.

7.4 Concept of Equitable Subordination

See **5.7 Rules Governing the Priority of Competing Security Interests**.

7.5 Risk Areas for Lenders

Once a company goes into liquidation any activity relating to property such as mortgage, charge, payments and so forth made up to six months prior to the commencement of the winding-up, could be considered as "fraudulent preference" and ultimately be set aside. This occurs when a creditor is given undue advantage over others and ends up having a better position than they would have, at a time when the company is not able to pay its debts. If found guilty, such creditors ought to pay back any benefit they obtained.

Where a transaction falls within the definition of a "financial collateral arrangement" under the Financial Collateral Arrangements Law, 43(I)/2004 (the "FCA Law"), such an arrangement is not automatically void based on the fact that a financial collateral agreement has been entered into or has been provided, within the timeframe of six months prior to the commencement of winding-up. If, however, such a transaction is considered to be a fraudulent preference of its creditors then it can still be set aside and in such a case the FCA Law should be interpreted on the basis of a "bona fide" person with no prior knowledge of any fraudulent dealings to defraud any creditors.

Furthermore, a floating charge created within twelve months of a company commencing wind-up procedures and which is currently in liquidation, will be void unless it is proved that the company was solvent after the creation of the said charge. If a charge is not registered as per the requirements the charge will be void against the liquidator and any creditor, but its validity will not have any interference with the chargor and the chargee.

8. Project Finance

8.1 Introduction to Project Finance

Cyprus project finance has evolved gradually, starting with the creation of the first desalination plants in 1996. Since then, there have been numerous other projects.

The biggest construction agreement ever handled in Cyprus has been the building of the two new international airports located in Larnaca and Paphos, with an injection of EUR640 million. The success of the project was big enough for World Finance to award it in 2013 as the "Best Transport Project in Europe", based on credentials of innovation, best practices and socio-economic advantages to its users.

Tourism

As a Mediterranean island, traditionally, tourism has been one of Cyprus' main sources of income and thus attracted ventures whose main focus is tourism, retail and leisure. These projects are increasing in size and project finance demands.

For example, the recent Limassol Marina, a EUR350 million waterfront development, is a build-operate-transfer (BOT) project financed by a mixture of equity and bank finance. Similarly, the Ayia Napa Marina (to be fully completed by 2023) is a EUR220 million BOT project. The same applies to the Larnaca and Limassol Desalination Plants which were completed using a mixture of private equity and project finance.

Depending on the type of project, different legislation is applicable concerning the project itself (for example, a EUR500 million casino development must comply with the gambling legislation, building regulations and private security rules) but in terms of finance, general company and contract law principles, as well as banking laws and regulations, apply, as described above.

8.2 Overview of Public-Private Partnership Transactions

Public-private partnership (PPP) transactions in Cyprus are constant. There is no finance specific PPP-enabling legislation currently in force but general public procurement laws and regulations, as well as specific legislation apply depending on the field of operations (see below and **8.1 Introduction to Project Finance**).

Both international airports of the Republic of Cyprus are managed by an operator with a BOT concession. The operator is an international consortium, containing various local and international partners such as dominant French construction groups and international airport operators.

Undisputedly, PPP is crucial and of major significance to the Cypriot economy, something that has been demonstrated by the Cyprus National Reform Programme of the Presidency's Unit for Administrative Reform, that mentioned that a certain PPP unit will be set up within the Public Works Department. Finally, since Cyprus is a member of the EU and stands in line with EU laws and regulations, it is deemed a free-market economy and there are thus practically no legal restrictions in contracting out certain services or utilities to private entities.

Current PPP Projects

The upcoming integrated casino resort "City of Dreams Mediterranean" in Limassol, one of the biggest casino projects in Europe, is again a consortium of international investors (Melco International) and local investors.

The discovery of natural gas in the vicinity of Cyprus has attracted the attention of multinationals such as Total, Exxon Mobil, Kogas, Qatar Petroleum and Eni which have started works for the extraction of the gas and to exploit potential oil deposits. Recent financing relates to the creation of an oil terminal and hydrocarbon-related infrastructure.

Requirements for PPP Projects

The Law on Fiscal Responsibility and Public Finances Framework of 2014 (Law 20(I)/2014) sets out the minimum public sector requirements when dealing and handling with PPP projects. The Law outlines what a "significant project" actually is (in cases where PPP is applicable), the assessment principles and other applicable specifications and tests that ought to be con-

ducted by the public sector when assessing PPP offers.

In addition, The Law on Public Procurement 73(I)/2016 (as amended) is the primary law on public procurement contracts in Cyprus. It effectively integrates the EU Procurement Directives 17/2004 and 18/2004 into domestic law, and handles the co-ordination of procedures for the award of public works contracts, public supply contracts, public service contracts and related matters.

8.3 Government Approvals, Taxes, Fees or Other Charges

Different government offices can be responsible for different project finance ventures. For example, in connection to the investigation and exploitation of hydrocarbons, the Hydrocarbon Service of the Ministry of Energy, Commerce, Industry and Tourism is in charge of providing related licences. Building and development activities are authorised by the Town Planning Service and in some cases by the local specialist service, which might require valuations of environmental repercussion.

Moreover, the National Betting Authority has been the authoriser when it comes to issues related to the operation of Cypriot casinos and casino resorts, whereas the Cyprus Tourism Association handles projects relating specifically to the tourist industry.

Overall, there are no specific documents required by or to be filed with any specific government body, other than those which are relevant to the issuing of government licences for the operations of the venture such as safety, environmental and health. Also, stamp duty may be imposed to finance documents and any applicable securities may need to be registered RoC.

8.4 The Responsible Government Body

As mentioned in **8.3 Government Approvals, Taxes, Fees or Other Charges**, the main government body in charge of oil, gas, power and mining in Cyprus, is the Energy Service of the Ministry of Commerce, Industry and Tourism. Along with the aid of some other government departments, they have assembled numerous Laws and Regulations, legislating the exploration and exploitation of hydrocarbons in Cyprus.

Cyprus has even passed a law, the Exclusive Economic Zone Law, 2004 (Law 64(I) of 2004, as amended) (the "EEZ Law") in compliance with the United Nations Convention on Laws of the Sea (UNCLOS 82) which outlines and controls its Exclusive Economic Zone (EEZ). According to the EEZ Law, Cyprus along with its neighbouring countries Egypt, Lebanon and Israel has signed the delimitation agreements which define Cyprus's EEZ.

In order for Cyprus to govern its gas and oil ventures, it has passed into domestic law Directive 94/22/EC of May 1994 (Directive 94/22) through the Hydrocarbons (Prospection, Exploration and Exploitation) Law (L.4(I)/2007), as amended (Hydrocarbons Law) and the Hydrocarbons (Prospection, Exploration, and Exploitation) Regulations of 2007 to 2019. Effectively, these allow member states to have self-governing rights over the hydrocarbon resources within their own regions.

8.5 The Main Issues When Structuring Deals

As with any project finance deal some of the main issues that will need to be considered are:

- procurement or transaction-specific experience to manage the project and local employ-

ment requirements in respect of foreign personnel/permits for non-EU citizens;
- financial – risk structuring and financial analysis, and affordability calculations;
- legal – due diligence, procurement advice and contract drafting; and
- environmental – environmental permits if applicable.

The most common form of corporate business vehicle used is a private company/special purpose vehicle representing the joint venture or a consortium. As noted, various legislation applies dependant on the specific industry sector. Overall, as part of Cypriot policy to attract foreign investors, investment by foreign nationals is permitted with the exception of certain regulated sectors such as banking defence and public utility companies. There are double taxation agreements and treaties with numerous countries, favouring investment in Cyprus.

8.6 Typical Financing Sources and Structures for Project Financings

A mixture of private equity, bank lending and, in some instances, venture capital seems to be the preferred structure for ventures and projects in Cyprus.

8.7 The Acquisition and Export of Natural Resources

Different legislation is set in place for each type of natural resource existing in Cyprus and depending on the industry of the project, various and/or different licences may be required prior to commencing any actual work.

Traditionally, mining activities were dominant in Cyprus and a licence to carry out such activities would be required by the Mining Service of Cyprus, for any exploration and exploitation of minerals as per the Mines and Quarries Law, Chapter 270 (as amended). A more recent example is the discovery of hydrocarbons in the region of Cyprus, which prompted the Hydrocarbon (Prospection, Exploration and Exploitation) Laws of 2007 to 2019. As mentioned in **8.4 The Responsible Government Body**, the EU Directive has been incorporated into Cypriot law, specifying the conditions for approving and authorising the prospection, exploration and production of hydrocarbons. Any successful licensee will be required to enter into an Exploration and Production Sharing Contract (EPSC), with the Ministry of Energy, Commerce, Industry and Tourism, as the relevant authority and ultimately share their revenues with the Republic of Cyprus.

The EPSC obliges the contractor to comply with the applicable tax laws and regulations of Cyprus and the EU, as a 5% withholding tax on gross income derived from within Cyprus is charged. However, in contrast, no exact tax regime is applicable in relation to oil and gas companies operating in Cyprus.

Furthermore, any grade-scale construction projects such as the construction of marinas, golf courses and/or hotel resorts, will require an assessment of the building procedures and environmental impact, as they may have harmful impact on the environment. In such cases, the Town and Country Planning Law 90/1972 (as amended) and the more recent Law on the Estimation of Repercussions on the Environment for Specific Construction Work, specify the requirements for the issuing of certain licences related to town planning and restrictions on foreign entities who are eligible to apply for such licences.

8.8 Environmental, Health and Safety Laws

There is no legislation specific to project financing. However, aside from general legislation such as the Safety and Health at Work Laws (89(I)/1996 as amended), depending on the specific industry, there may be further regulations regarding the operations and safety requirements specific to that sector, eg, in order to protect the worker and the environment in natural resource projects, the Safety and Health at Work (Safety of Offshore Oil and Gas Operations) Regulations of 2015 (P.I. 424/2015) have been introduced under the Safety and Health at Work Laws of 1996 to (No 2) of 2015 (the "Regulations"). The Regulations lay down minimum requirements for the prevention of major accidents during offshore oil and gas operations and the mitigation of the consequences of such accidents.

In addition the Law on Environmental Liability with regard to the Prevention and Remedying of Environmental Damage No 189(I) of 2007 (as amended) renders any natural or legal, private or public person who operates or controls the occupational activity or to whom decisive economic power over the technical functioning of such an activity has been delegated by law, (including the holder of a permit or authorisation for such an activity or the person registering or notifying such an activity) liable for environmental damage caused. According to the law, strict liability is imposed upon the operator, for charges of prevention and remediation of environmental damage caused by any of its registered "occupational activities", this incorporates "any activity carried out in the course of an economic activity or an undertaking, irrespectively of its private or public, profit or non-profit character".

The competent authority for Cyprus is the Environmental Authority of the Ministry for Agriculture, Natural Resources and Environment. A lender financing a project or a guarantor providing security for a project, is not liable under environmental legislation unless it is deemed to be an operator.

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