Lending and taking security in Cyprus: overview

by *Lia Iordanou Theodoulou*, *Angeliki Epaminonda*, *Elena Georgiou* and *Georgia Kampanelli*, Patrikios Pavlou & Associates LLC

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A Q&A guide to finance in Cyprus. The Q&A gives a high level overview of the lending market, forms of security over assets, special purpose vehicles in secured lending, quasi-security, guarantees, and loan agreements. It covers creation and registration requirements for security interests; problem assets over which security is difficult to grant; risk areas for lenders; structuring the priority of debt; debt trading and transfer mechanisms; agent and trust concepts; enforcement of security interests and borrower insolvency; cross-border issues on loans; taxes; and proposals for reform.

To compare answers across multiple jurisdictions, visit the *Lending and taking security in country Q&A tool*.

This article is part of the global guide to finance. For a full list of contents visit *www.practicallaw.com/finance-guide*.

Overview of the lending market

1. What have been the main trends and important developments in the lending market in your jurisdiction in the last 12 months?

Secured lending

The financial situation in Cyprus has conspicuously improved after facing a series of hurdles since the banking crisis in March 2013, although lending is generally still very low. As recorded in a recent survey on bank loans published by the Central Bank of Cyprus in January 2017, it was expected that there would be no substantial changes to the criteria for granting loans during the first three months of 2017. Additionally, the survey noted that the demand for loans marked a steady increase in the last three months of 2016, estimating that this rise will continue to develop. Some of the main reasons for this increase are the:

- Reduction of interest rates.
- Need to increase the movement of capital and stocks.
- Essential need for debt and corporate restructuring.

However, even though the financial future of Cyprus may seem brighter, the lending market still faces a high rate of non-performing loans that has yet to be overcome. Cyprus banks are taking steps in reducing their "red" loans, including through restructuring methods, such as conversion of debt into equity, applying the new legislation for debt to asset restructuring and implementing recently enacted legislation in relation to foreclosure and insolvency. The country requires a high level of compliance in the banking sector through a number of demanding statutory requirements. This results in the reinforcement of the lending market, with the reliability and consistency it needs.

Unsecured lending

Unsecured loans are extremely difficult (if not impossible) to obtain, as was the case in some circumstances in the past.

Forms of security over assets

Real estate

> 2. What is considered real estate in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected (that is, made valid and enforceable)?

Real estate

Real estate includes land, buildings and natural resources of the land (*Immovable Property (Tenure, Registration and Valuation) Law, Cap. 224, as amended*).

Common forms of security

The most common form of security is a mortgage. A mortgage, which is distinct from a charge, gives to the mortgagee a proprietary right in the immovable property and a right to foreclose or sell on default in repayment of the loan. On redemption (that is, on the mortgagor's repayment), the ownership is vested back in the mortgagor.

A mortgage can be legal or equitable. A legal mortgage is only constituted when registered as described below. An equitable mortgage can be created either by:

- An express instrument agreeing to transfer the legal ownership in the property to the creditor.
- Depositing ownership documents of the relevant property with the creditor.

Formalities

A legal mortgage over immovable property is created by an instrument in writing signed by the mortgagor and the mortgagee, on Form B, which is provided by Annex II of the Transfers and Mortgages Law, No 9/1965 (Transfers and Mortgages Law). Both the mortgagor and the mortgagee, through their duly authorised representatives, must attend the district land office where the immovable property is situated and declare the mortgage to a qualified officer by presenting the signed instrument (*section 8, Transfers and Mortgages Law*). On registration, no subsequent transfer or further mortgaging is possible, except with the mortgagee's consent.

A mortgagor that is a legal entity must also register the mortgage under section 90 of the Companies Law, Cap. 113, as amended (Companies Law) with the Department of the Registrar of Companies (ROC) and Official Receiver, on the prescribed form (HE24Y) within the prescribed time limit. Failure to register the mortgage with ROC will render

the mortgage void against the liquidator and any creditor of the company, but the mortgage will remain valid and enforceable as between the mortgagor and the mortgagee.

Tangible movable property

3. What is considered tangible movable property in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected?

Tangible movable property
Tangible movable property includes (*section 2, Financial Lease Law No 72/2016*):

- Plant and machinery that is not permanently affixed to land or buildings.
- Goods.
- Equipment.
- Trading stock.
- Works of art.
- Aircraft and ships.

Common forms of security
The most common type of security is a fixed or floating charge (debenture). A charge does not give any proprietary right or interest in the property or asset charged, but gives the chargee the right to look into the asset and its proceeds for the purpose of enforcing the secured obligations.

A fixed charge gives the chargee control over any dealings or disposals of the tangible property by the chargor.

The assets of the chargor that are less ascertainable from time to time are secured by a floating charge, which gives the chargor the right to deal with the assets in the ordinary course of business. A floating charge is a security interest that "floats" until an event of default occurs or until the company goes into insolvent liquidation, at which time the floating charge "crystallises" and attaches to all the relevant assets. In practice, floating charges are created over the whole business and undertaking of a company, present and future.

Another common form of security is the lien, whether a common law legal lien or an equitable lien. A lien is usually taken over goods that are being transported. The lien only gives the holder the right to retain the debtor's property until payment, and does not include a right of sale. Therefore, a carrier's lien (that is, a right to retain possession of the goods) is extinguished against payment of transport costs.

See *Question 24* for information on the ranking of claims on a winding-up or liquidation of a Cyprus corporate chargor.

Formalities
A chargor under a fixed or a floating charge that is a Cyprus legal entity must register the charge with the Registrar of Companies (ROC) on payment of the prescribed fee within the prescribed statutory time limit (*section 90, Companies Law, Cap. 113, as amended* (Companies Law)). A charge that is not registered is invalid against the future liquidator of the legal entity.

Ship mortgages over Cyprus registered vessels are used extensively in shipping finance transactions. The mortgage instrument (normally a mortgage deed) creates the security over the vessel and is executed only by the mortgagor. This must be supported by a deed of covenants entered into by the mortgagor and the mortgagee, covering the terms and provisions under which the mortgage is granted. Unlike in other Anglo-Saxon law jurisdictions, the collateral deed of covenants must be attached to the mortgage as a matter of statutory requirement, therefore forming a composite mortgagee document known as "statutory mortgage and deed of covenants". The mortgage and covenants must be registered with the Registrar of Cyprus Ships or at the Cyprus consulate overseas. When the mortgaged vessel is owned by a Cyprus company, the mortgage must also be registered with the ROC (*section 90, Companies Law*). Mortgages have priority over one another according to the date of registration with the ROC.

Aircraft mortgages over Cyprus registered aircraft are also used in aircraft financing transactions. They are registrable by a Cypriot corporate mortgagor with the ROC under section 90 of the Companies law. Registration with the Cyprus Aircraft Register is also necessary if the aircraft is Cyprus registered (*Civil Aviation Law, No 212(I) of 2002, as amended*).

In ship and aircraft financings, it is also common to have assignments by way of security, involving mainly assignment of insurances and earnings. These security assignments are registrable under section 90 of the Companies Law and as an additional formality. Notice of the assignment must be given to the counterparty.

Financial instruments

4. What are the most common types of financial instrument over which security is granted in your jurisdiction? What are the most common forms of security granted over those instruments? How are they created and perfected?

Financial instruments
The most common types of financial instrument over which security is granted are shares and debt instruments. Financial instruments include (*Financial Collateral Arrangements Law, 43(I)/2004, as amended; Directive 2002/47/EC on financial collateral arrangements*):

- Shares in companies and other securities equivalent to shares in companies and bonds and other forms of debt instruments, if these are negotiable on the capital market.
- Any other securities that are normally dealt in and that give the right to acquire any such shares, bonds or other securities by subscription, purchase or exchange or which give rise to a cash settlement (excluding instruments

of payment) (including units in collective investment undertakings, money market instruments and claims relating to, or rights in or in respect of, any of those).

Common forms of security

The most common form of security taken over shares that are held directly (such as certificated shares in private companies) is the pledge. A share pledge is a possessory form of security, as it involves the physical delivery to the pledgee of the share certificates representing the pledged shares. As such, a pledge creates both a legal charge over the share certificates and an equitable charge over the shares.

For dematerialised securities (such as shares in listed companies traded on the Cyprus Stock Exchange (CSE)), a charge can be taken over the special account of the investor's share account, which will be registered in the Central Securities Depository and Central Registry of the CSE.

The most common forms of security granted over debt instruments that are indirectly held (such as bonds and other tradeable debt securities) are a charge or an assignment, or both.

Formalities

A deed of pledge is sometimes drafted in such a way as to include a fixed charge.

A pledge of shares held by a corporate shareholder/pledgor, whether a Cyprus company or not, in a Cyprus company, is not registrable (*section 90(2), proviso (a), Companies Law, Cap. 113, as amended* (Companies Law)). When the pledge is taken over a foreign company's shares and the pledgor is a Cyprus registered company, the pledge must be registered as a charge with the Cyprus Registrar of Companies (ROC) to be perfected and valid against the pledgor's liquidator (*section 90, Companies Law*).

For a pledge over shares of a Cyprus company to be valid and enforceable, the formalities of section 138 of the Contract Law, Cap 149 (Contract Law) must be observed, namely:

- The pledge must be made in writing.
- The pledge must be signed by the pledgor and the pledgee, and witnessed by at least two witnesses.
- Notice of the pledge must be given by the pledgee to the company whose shares are being pledged.
- The company whose shares are being pledged must enter a memorandum of the pledge in the company's records.
- The company must issue and deliver to the pledgee a certificate executed by the appropriate official of the company confirming the registration of the pledge in favour of the pledgee.

A Cyprus share pledge is a very useful tool in the hands of a pledgee, as it can be enforced relatively easily out of court.

Where the security is financial collateral, there are no formalities (*section 90(2), proviso (b), Companies Law*) and the requirements of section 138 of the Contract Law do not apply.

Claims and receivables

5. What are the most common types of claims and receivables over which security is granted in your jurisdiction? What are the most common forms of security granted over claims and receivables? How are they created and perfected?

Claims and receivables
The most common types of claims and receivables over which security is granted are:

- Rights and receivables under contracts.
- Payment obligations under contracts.
- Claim rights and proceeds under insurance policies (usually life insurance and fire insurance contracts).
- Bank accounts and cash deposits.
- Promissory notes.
- Book debts.
- Rent receivables.

Common forms of security
The form of security over receivables is at the discretion of the contracting parties, and depends on their commercial interests and on whether the security provider wishes to maintain control over the secured receivables in its ordinary course of business. The most common forms of security include:

- Equitable assignment.
- Lien.
- Fixed or floating charge.
- Pledge.

Formalities
There are no statutory formality requirements for creating an equitable assignment, lien, charge, or pledge over property other than bills of exchange, promissory notes, bonds and shares. The security agreement is most commonly executed in writing. The agreement will be valid and enforceable if it complies with common law rules of contract law and it is not rendered void or voidable under any of the provisions of the Contract Law, Cap 149 (Contract Law).

An equitable charge, assignment, lien or charge can be granted over future property. However, a pledge cannot be granted over future property. The pledgor can only be the owner, possessor or a person having a limited interest in the movable property.

It is possible to create a pledge over any kind of movable property. The formalities of section 138 of the Contract Law (*see Question 4, Formalities*) only apply when constituting a pledge over:

- Bills of exchange.
- Promissory notes.
- Bonds.
- Share certificates.

Unless agreed otherwise, compliance with the formalities entitles the pledgee, on default of the pledgor, to:

- The same rights and remedies on the pledge against third parties as the pledgor would have had but for the existence of the pledge agreement (and all payments made to the pledgee by third parties on the pledge are as valid and effective as if made to the pledgor).
- Initiate legal action against the pledgor and withhold the pledged assets, or to sell them after giving reasonable notice to the pledgor.

There are no other statutory provisions specifying the enforcement rights and remedies available to the beneficiary of security taken over receivables. The common practice is to detail these rights and remedies in the security agreement.

The perfection requirements in relation to securities or any subsequent amendments created over claims and receivables of a legal entity can be found in the Companies Law, Cap.113, as amended (Companies Law). A security over receivables is only registrable when it is granted over any of the following (*section 90(2), Companies Law*):

- Book debts of the company.
- The undertaking or property of the company, by a way of a floating charge.
- Any other movable property, if created or evidenced by a document where the company retains possession of such property.

Registration does not affect the validity of the security agreement between the contracting parties, but perfects the security and renders it enforceable against any liquidator or creditor of the company.

In relation to equitable securities, such as assignments and charges, there is an additional common law perfection requirement stemming from *Dearle v Hull rule (Dearle v Hall [1828] 3 Russ 1*). Namely, the first security holder to give notice to the contracting third party gains priority over the remaining equitable interests in the property.

Cash deposits

6. What are the most common forms of security over cash deposits? How are they created and perfected?

Common forms of security

The most common forms of security over cash deposits are as follows:

- Banker's general lien.
- Fixed or floating charge.
- Assignment.
- Pledge.

A charge over a bank account can be granted in favour of a third party. Most frequently, the charge is created in favour of the lender and account holder bank. A banker's general lien exists impliedly in every banker-customer relationship, unless the parties contract out of it (see *Nikolaos Antoniou v Cyprus Popular Bank (1994) 1 ΑΑΔ 720* and *Halesowen Presswork v Westminster Bank Ltd [1970] 1 All E.R. 473*). The banker's general lien allows the banker to set off the credit and debit accounts that the customer holds with the bank for discharging a debt owed to the bank.

Another option available to an account bank as a secured lender is to provide for a flawed asset clause in the security agreement. Flawed asset clauses offer protection against the capacity of judgment creditors to apply for a garnishee court order in relation to property beneficially belonging to the debtor, but which is in the possession of a third party (*see Part 7 of the Civil Procedure Law Cap. 6, as amended*).

Formalities
See *Question 5, Formalities*.

Intellectual property

7.What are the most common types of intellectual property over which security is granted in your jurisdiction? What are the most common forms of security granted over intellectual property? How are they created and perfected?

Intellectual property
The most common types of intellectual property over which security is granted in Cyprus are:

- Copyright.
- Patents.
- Trade marks.
- Designs.

Common forms of security
The most common forms of security granted over intellectual property are:

- Equitable assignment.
- Pledge.
- Floating charge.

There are many pieces of legislation on intellectual property rights, such as the Intellectual Property Law (59/1976), Trade Marks Law Cap. 268, Patents Law (16/1998), Industrial Designs Law (4/2002) and the Protection of Competition Law 2008. Cyprus is gradually widening the intellectual property protection it offers, while taking considerable steps in encouraging the growth of its intellectual property market.

Formalities
The creation of security over intellectual property is not expressly governed by any intellectual property legislation. The Intellectual Property Law (59/1976) only states generally that intellectual property rights are capable of assignment by an agreement in writing. As for receivables, the validity and enforceability of the security depends on compliance of the security agreement with the common law and the provisions of the Contract Law, Cap 149. In relation to Community trade marks, an assignment will be void unless it is executed in writing and signed by the parties (*Regulation (EC) 207/2009 on the Community trade mark*).

The Intellectual and Industrial Property Department, operating under the auspices of the Registrar of Companies (ROC), handles the registration of intellectual property rights. Security and any subsequent amendments over intellectual property, or over a patent or copyright licence, created by a company registered in Cyprus are registrable with the ROC (*section 90, Companies Law, Cap. 113, as amended*).

Problem assets

8. Are there types of assets over which security cannot be granted or can only be granted with difficulty? Which assets are difficult or problematic when security is granted over them?

There are no restrictions on the type of assets over which security can be granted.

Future assets
Any type of security can be granted over future assets, except a legal mortgage and a pledge.

Fungible assets
Any type of security can be granted over fungible assets, except a legal mortgage.

Other assets
There are no particular assets over which security cannot be granted. However, a potential security holder must be aware of the following:

- Incapability of certain receivables and contractual rights to be charged due to prior contractual restrictions.
- Restrictions on granting security imposed by a company's memorandum and articles of association.
- A company granting security must not breach statutory provisions on corporate benefit, directors' duties, financial assistance and fraudulent preference.

Release of security over assets

9. How are common forms of security released? Are any formalities required?

Security is usually released by agreement between the contractual parties.

When a legal mortgage over immovable property is released, the property will be considered released when the mortgagor and the mortgagee, being present in the relevant district land office, file the appropriate documents as set out in the Transfers and Mortgages Law, No 9/1965. The mortgagor can apply for a court order to cancel the mortgage when the mortgagee denies or omits to release the mortgage despite the discharge of the secured obligations.

When a security granted constitutes a registrable charge under the Companies Law Cap.113, as amended (Companies Law), the Registrar of Companies (ROC) can release the security either (*section 95, Companies Law*):

- On the partial or whole repayment of the secured debt.
- On proof that part of the secured property has been released or does no longer belong to the security provider.

Recording the release with ROC is merely a formality and does not affect the validity of the release.

Special purpose vehicles (SPVs) in secured lending

10. Is it common in your jurisdiction to take security over the shares of an SPV set up to hold certain of the borrower's assets, rather than to take direct security over those assets?

It is common to take security over the shares of an SPV borrower, as it is easier and more cost-efficient to enforce security taken over shares of an SPV rather than taking security over its entire assets. A pledge over a Cyprus company's shares allows automatic enforcement, without the need to apply for a court order.

Quasi-security

11. What types of quasi-security structures are common in your jurisdiction? Is there a risk of such structures being recharacterised as a security interest?

In considering whether quasi-securities carry the risk of being recharacterised as security interests, it is worth noting that there is no statutory definition of what constitutes a security interest under Cypriot law. Since common law and equity are directly applicable in Cyprus, by virtue of section 29(1)(c) of the Courts Law 14/1960, the Cypriot courts will have recourse to the common law definitions of "security interest" offered by English case law, before recharacterising quasi-security structures.

In deciding on whether a quasi-security structure constitutes a security interest, the court will ascertain the intention of the contracting parties and examine whether one or more security characteristics under common law case law are present, namely that (*McEntire v Crossley Brothers Ltd [1895] AC 457, Armour v Thyssen Edelstahlwerke AG [1991] 2 AC 339*):

- A security interest is created by grant, not by reservation.
- In the event of asset realisation for the satisfaction of the secured debt, the debtor is entitled to any surplus or remains liable for the balance after realisation.
- A borrower has the right to redeem (that is, to free the secured asset by paying the debt).

Sale and leaseback

A sale and leaseback is defined as a transaction under which the lessee (borrower) chooses an asset that is then bought by the lessor (lender), or the lessee transfers the ownership title of an asset to the lessor, who then leases it back to the lessee by the (*Financial Leasing Law 72/2016* (Financial Leasing Law)). Although the economic effect of these transactions is the same as an asset secured loan, they are not usually recharacterised as such. Essentially, the lessor (lender) holds an absolute interest in the leased asset and not merely a security interest, since the lessor is the owner of the leased asset. The lessor grants to the lessee a right of possession, which can be withdrawn on the default of the lessee.

Section 37 of the Financial Leasing Law imposes a registration requirement within one month of the sale and leaseback agreement. Depending on the type of property sold and leased, the transaction is recorded on the relevant register. In the event of an aircraft or motor vehicle sale and leaseback registration, a right *in rem* is created in favour of the lessee, which attaches to the registered asset even if the owner of the asset sells it to a bona fide third purchaser. In the event of a sale and leaseback agreement of immovable property, the lessee has the additional right to demand specific performance. These provisions should not be confused with the registration requirements

applicable in relation to security agreements. In effect, the registration of the sale and leaseback agreement protects the ability of the lessee (debtor) to exercise its option to purchase the leased asset.

As the Financial Leasing Law has not yet been tested, it is not known whether Cypriot courts would recharacterise a sale and leaseback as a secured loan.

Factoring

Cyprus banks offer factoring services. Factoring is when a company sells its book debts to a factoring company (lender), which in return provides finance to the company. The factoring company is usually responsible for collecting the debts directly from the customers of the company. Although the economic effect of factoring is similar to the company obtaining a secured loan, it will not be recharacterised as a secured transaction since the lender obtains an absolute interest in the books debts and not a security interest over them.

Hire purchase

Under the Hire-Purchase Law 32/1966 and the Finance Leasing Law, a hire purchase is a contract under which a lessee receives certain property from the lessor, in return of instalments and with the lessee's right to buy the leased property. The Supreme Court of Cyprus stated that a hire purchase transaction is constituted by two distinct contracts, namely a bailment contract during which the property remains under the possession of the lessee, and a sale contract (*Solomou a.o v Marfin Popular Bank Ltd (2011) 1 ΑΑΔ 36*). In light of Cypriot case law, it is evident that the courts do not treat hire purchase transactions as security interests. The absolute title to the leased property remains with the lessor up and until the lessee exercises his or her optional right to purchase the property.

Retention of title

Retention of title clauses must be contractually agreed upon by the transaction parties, as the unpaid seller has no automatic title retention right under Cyprus law (*section 12, Late Payments in Commercial Transactions Law 123/2012; section 19, Sale of Goods Act 10/1994*). A simple retention of title (Romalpa clause) under which the title of goods remains with the seller until the buyer fulfils his or her obligations, will not carry the risk of being recharacterised as a security interest. The debtor (buyer) has no proprietary interest in the purchased goods, and is therefore not able to grant security over them. The effect of a Romalpa clause is best characterised as the retention of an absolute interest in the goods and not as a security interest, which can only be by grant and not by retention.

However, a retention of title clause carries the risk of being recharacterised as a security interest where the term either:

- Is an all monies clause.
- Provides that the seller's proprietary right attaches to any proceeds of sale or products made out of the sold goods.

These cases have not yet been tested before the Cypriot courts. It is advisable to draft these clauses in such a form so that they can be severable from the retention of title clause, so that the clause cannot be invalidated against the liquidator for want of registration.

Other structures

A negative pledge is a contractual undertaking that a lender may request to ensure that the borrower is prohibited from granting a security interest in the future to other creditors. It does not amount to a security interest.

A set-off arrangement can arise by law, contract or equity. It is not a security interest, as it does not afford a proprietary right in an asset.

Guarantees

12. Are guarantees commonly used in your jurisdiction? How are they created?

A company commonly provides a guarantee as security for the payment of money owed by itself or a third party, provided that the company providing the guarantee has the corporate power to do so. In the absence of corporate power, a corporate guarantor must show that it will receive a corporate benefit in providing the guarantee and that the guarantee will serve its commercial and business interests.

Guarantees are normally created by way of a written contract and are subject to general contractual principles.

Risk areas for lenders

13. Do any laws affect the validity of a loan, security or guarantee (or the terms on which they are made or agreed)?

The general principles of contract law may affect a loan, security or guarantee. They may also affect specific terms of a loan agreement (for example, a very high interest rate in the case of default may be unenforceable as being a penalty).

Financial assistance
Section 53 of the Companies Law contains a prohibition of financial assistance by a company for the purchase or subscription of its own shares, or those of its holding company. However, there is no definition of "financial assistance". The main prohibition of financial assistance contained in the Companies Law is identical to the prohibition under section 54 of the old English Companies Act 1948. In this respect, English case law on the matter offers useful guidance for legal practitioners, in the absence of a clear definition. It is apparent from authorities on the matter that the provision or granting of any loan, guarantee or security falls within the meaning of financial assistance.

Recent amendments to the Companies Law have introduced whitewash provisions, under which financial assistance by a private company for the acquisition of its own shares, or those of its holding company, is no longer unlawful where both:

- The private company is not a subsidiary of a public company.
- The transaction was approved in a general meeting by means of a resolution of the shareholders representing 90% of the company's issued share capital.

Corporate benefit

Directors owe a duty to their company to act in good faith for the benefit of the company. The benefit of a company acting as a guarantor in a particular transaction is much easier to establish when it relates to a subsidiary (downstream guarantee) and more difficult in cases where a subsidiary is called to provide a guarantee for its parent company (upstream guarantee) or a sister company (cross-stream guarantee). Additionally, if the amount secured by the guarantee exceeds or equals the asset value of the guarantor, this is another obstacle in proving corporate benefit.

Loans to directors

Directors have a general duty to avoid conflicts of interest in the exercise of their duties. Since directors hold a fiduciary position, they must exercise their powers in this capacity. The fiduciary relationship is with the company, not with its shareholders. Additionally, the directors of a company cannot personally benefit from a particular transaction. A director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company is under a duty to declare the nature of his or her interest at a board meeting (*section 191(1)-(3), Companies Law*). The declaration must be made:

- At the board meeting on which the question of entering into the transaction is first considered.
- If the director did not have an interest at the time, at the next board meeting held after the interest has arisen.
- At the first meeting of the directors held after the interest has arisen, in cases where the director developed an interest following the conclusion of a contract or transaction.

Additionally, it is unlawful for a company to provide (*section 182, Companies Law*):

- A loan to any person who is its director or a director of its holding company.
- Any guarantee or security in connection with a loan provided to such a director by any other person.

There are certain exceptions to the above prohibitions.

Usury

Under section 314A of the Criminal Code, Cap. 154, as amended (Criminal Code), and further to the amendment introduced in 2011, usury is a criminal offence that, on conviction, is punishable with imprisonment not exceeding five years or a fine not exceeding EUR30,000, or both. A person is prohibited from receiving, collecting or charging interest at a rate that is higher than the interest rate ceiling during the:

- Provision of any loan.
- Provision or extension of a payment deadline.
- Renewal or prepayment of any loan.

This prohibition does not apply to credit institutions.

The Central Bank of Cyprus, exercising its power under section 314A of the Criminal Code, calculates the interest rate ceiling every three months, which is published in the *Official Gazette* of the Republic of Cyprus. To calculate the interest rate ceiling, the average bank lending interest rates of the previous year (including commissions, encumbrances and any other relevant charges or any fees charged by credit institutions for consumer loans) is increased by half, with a margin between five and ten percentage points. The current interest rate ceiling as of 28 April 2017 is 9.12%.

14. Can a lender be liable under environmental laws for the actions of a borrower, security provider or guarantor?

A lender will not be automatically liable under the environmental legislation for the actions of a borrower, security provider or guarantor.

However, care must be taken where the lender becomes an "operator" under the Law on Environmental Liability with regards to the Prevention and Remedying of Environmental Damage No 189(I) of 2007. This imposes strict liability on the operator in respect of the costs of prevention and remediation of environmental damage caused by any of the occupational activities.

Structuring the priority of debts

15. What methods of subordination are there?

Contractual subordination
Contractual subordination of debt is possible and quite common in lending transactions. This is typically achieved by agreement between the senior lender, junior lender and borrower.

Structural subordination
Structural subordination is another possible method of structuring the priority of debts. Structural subordination is achieved contractually by concentrating the senior debt in an active company of the group, which has available assets, and directing the junior debt to the parent company. However, these contractual arrangements should be carefully constructed so that they do not run the risk of being considered ineffective if caught by the fraudulent preference provisions of the Companies Law.

Inter-creditor arrangements

Inter-creditor arrangements are common. They are made typically between the lenders and the borrower company by means of an inter-creditor agreement, which sets out the terms of their relationship.

Debt trading and transfer mechanisms

16. Is debt traded in your jurisdiction and what transfer mechanisms are used? How do buyers ensure that they obtain the benefit of the security and guarantees associated with the transferred debt?

Debt trading is not a usual practice in Cyprus. However, debt can be transferred by assignment of the benefit or rights associated with the debt. If the intention is not only to assign the benefit but also the liabilities under the loan agreement, this will be done by means of a novation agreement. The buyers can ensure that they obtain the benefit of the security and guarantees associated with the transferred debt through relevant clauses in the assignment or novation agreement.

Agent and trust concepts

17. Is the agent concept (such as a facility agent under a syndicated loan) recognised in your jurisdiction?

The concept of agency is recognised in Cyprus. Agency is governed by several pieces of legislation, including sections 142 to 198 of the Contract Law, Cap. 149 (Contract Law). An agent is defined as a person employed to do any act for another, the principal, or to represent the principal in dealings with third parties (*section 142, Contract Law*). Any person who has capacity to contract can appoint an agent (*section 143, Contract Law*).

A contract entered into by an agent, as well as any obligations arising from the acts of the agent, are enforceable in the same manner and will have the same legal consequences as if the contract had been entered into and the acts done by the principal in person (*section 186, Contract Law*).

Recent UK case law, on which the Cyprus courts draw guidance, suggests that the role of the facility agent in finance transactions is limited and the terms of any finance document are of crucial importance. If a party wishes a facility agent or entity to undertake a specific duty or act in several capacities, this duty is not implied and must be expressly set out in the relevant documentation.

18. Is the trust concept recognised in your jurisdiction?

The concept of trust is recognised in Cyprus, which has a common law legal system. The applicable Cyprus laws relating to trusts are the:

- Trustees Law, Cap. 193, as amended.
- International Trusts Law of 1992 No 69(I)/1992, as amended.

A trust can be used as a means of holding security over the assets of a debtor for a number of creditors (for example, in a syndicated loan or a securitisation transaction).

The security trustee, as a matter of principle, owes a fiduciary duty to the beneficiaries of the trust property, specifically the lenders in a loan. However, in the finance lending market where parties choose to govern their relationship by drafting commercial contracts, the scope and nature of the duties of a security trustee are defined by the contractual terms.

Enforcement of security interests and borrower insolvency

19. What are the circumstances in which a lender can enforce its loan, guarantee or security interest? What requirements must the lender comply with?

This will depend on the terms of the loan, guarantee or security documentation, which will set out the circumstances in which an enforcement right is triggered, as well as the manner in which enforcement can be exercised. The actual events that trigger enforcement are contractually agreed between the parties and are normally set out as enforcement events or events of default.

Before enforcing a security interest, the enforcing party must:

- Ensure that a right of enforcement does in fact exist (that is, that an event of default has taken place).
- Determine when and in what manner the enforcement must be undertaken.
- Consider whether there are any restrictions that may exist which would prevent the enforcement from taking place (for example, a subordination agreement or an inter-creditor agreement).

In addition, where the loan, guarantee or security document is connected with other documents, the provisions of all the documents regarding enforcement may need to be considered.

Methods of enforcement

20. How are the main types of security interest usually enforced? What requirements must a lender comply with?

The mechanism for enforcement of a security interest is usually set out in the security document. The security document will specify whether there is a right of sale, appropriation, set-off, realisation or management of underlying assets, or a right to appoint a receiver.

Some security documents (for example, a pledge over shares) provide for out-of-court enforcement through the use of pre-delivered deliverables.

Where the security document gives the security holder the power to sell the asset covered by the security, the asset must be sold at market value. Cyprus law does not require a sale to be done in a public sale or auction.

In addition, where a receiver or manager is appointed on behalf of a floating charge holder, the following provisions of the Companies Law apply:

- The receiver or manager must immediately notify the company of his or her appointment.
- Within 14 days after receiving the notice, or such greater time frame as may be permitted by the court or the receiver/manager, the company must prepare a statement of affairs in the prescribed form and submit it to the receiver/manager.
- Within two months following receipt of the statement, the receiver/manager must deliver for registration:
    - to the Registrar of Companies and the court: a copy and summary of the statement, and any comments on the statement;
    - to the company: a copy of any comments on the statement; and
    - to any trustees of the debenture holders on whose behalf he or she was appointed and to all the debenture holders (to the extent that he or she is aware of their addresses): a copy of the summary of the statement.

Rescue, reorganisation and insolvency

21. Are company rescue or reorganisation procedures (outside of insolvency proceedings) available in your jurisdiction? How do they affect a lender's rights to enforce its loan, guarantee or security?

Corporate reorganisation

The Companies Law, Cap. 113, as amended (Companies Law) allows for corporate reorganisations to take place in the form of compromises or arrangements. Corporate reorganisations can take any of the following forms (*section 30, Income Tax Law 118(I) of 2002, as amended*):

- Merger.
- Division.
- Partial division.
- Transfer of assets.
- Exchange of shares.
- Transfer of registered office.

A compromise or arrangement is normally proposed between the company and its creditors or the company and its members. An application is usually made to the relevant district court by the company or any creditor or member of the company, requesting an order that a meeting either of the creditors or the members of the company (as the case may be) be convened. If the majority in value of the creditors or members present and voting either in person or by proxy agree to the compromise or arrangement, an application is made to the court for sanctioning. Once the court has sanctioned the compromise or arrangement, it becomes binding on all the creditors or members, as the case may be.

Cross-border merger

This involves the merger of one or more entities incorporated under the Companies Law with one or more entities governed by the law of a member state of the European Economic Area other than Cyprus. The procedure involves the passing by the directors of the Cyprus entity of a resolution proposing the merger and approving a common draft terms of merger that will be drawn up. The common draft terms of the cross-border merger are then filed with the Registrar of Companies (ROC) together with the relevant announcement. The ROC proceeds with publishing the announcement in the *Official Gazette* at least one month before the date of the general meeting.

The directors must also draw up a report that must be made available to the shareholders and to any employees or their representatives.

An independent expert report intended for members may also be necessary, unless the shareholders of both companies pass a resolution disapplying this requirement, which is the usual practice.

Provided that the above conditions are satisfied, the general meeting of the shareholders can approve the merger.

The above is followed by an application to the court for the pre-merger. Thereafter, the relevant formalities are taken for completion of the merger.

Resolution measures

The Law on the Resolution of Credit Institutions and Investment Companies No 22(I) of 2016 (Resolution Law) implements the provisions of Directive 2014/59/EU on Bank Recovery and Resolution (BRRD). BRRD provides the minimum threshold of measures that must be taken and tools that must be adopted in connection with failing or unsound credit institutions and investment firms by each member state.

On the basis of the Resolution Law, the Resolution Authority, comprised of the Central Bank of Cyprus, has the power to adopt and implement resolution measures using the following tools (individually or in conjunction with one another) on affected institutions:

- Sale of business tool.
- Transfer of assets, rights or obligations to a bridge institution.
- Transfer of assets and rights to an asset management company.
- Bail in tool.

Resolution measures can only be taken where the following conditions are satisfied:

- The competent authority, after consulting the Resolution Authority, determines that the institution is insolvent or is facing potential insolvency.
- Having regard to timing and other relevant circumstances, there is no reasonable prospect that any private sector alternative measures, including early intervention measures, or the write-down or conversion of relevant capital instruments would prevent the insolvency of the institution within a reasonable time frame.
- A resolution measure is necessary for reasons of public interest.

Examinership

The Companies Law has recently introduced the examinership procedure, which aims to rescue a viable company with liquidity problems through reorganisation in an effort to prevent or avoid liquidation and to provide relief from actions of creditors, so that the company has the time to reorganise its financial affairs. On the filing of a petition, the court can appoint an examiner if it considers that all the following conditions are met:

- The company is, or will most likely be, unable to pay its debts.
- No resolution for the liquidation of the company has been published in the *Official Gazette* of the Republic of Cyprus.
- No court order has been issued for the liquidation of the company.

The court will only issue an order for examinership if it is satisfied that there is a reasonable prospect of survival of the company and the whole or part of the business of the company as a going concern.

The company goes under court protection for a period of four months from the date of the filing of the petition with the court, with the possibility of a two-month extension. The following applies during the court-imposed moratorium period (among other things):

- No winding-up proceedings can be commenced against the company.
- A receiver cannot be appointed and the company cannot be placed in liquidation.

- No confiscations by third parties, including sequestration proceedings or enforcement, can be carried out against the assets or property of the company without the consent of the examiner.
- Where any claim against the company is secured by a mortgage, charge, lien or other charge or pledge over the whole or any part of the assets, property, or income of the company, no action can be taken for the enforcement of the whole or any part of the security without the consent of the examiner.
- No payment can be made by the company for the settlement or repayment of the whole or a part of an obligation created at a date prior to the submission of an application for examinership, unless the report of the independent expert includes a recommendation that such payment is made or the examiner authorises it.

Since the procedure has been newly introduced into Cyprus law and has yet to be put into action, the potential effects of the examinership procedure, and whether this will result in any delays or stays in exercising enforcement rights, remain unclear.

However, at a seminar on examinership conducted on 17 October 2015 by the Insolvency Service (which is part of the Department of Registrar of Companies and Official Receiver), it was specified that, as a basic principle, creditors will not be placed in a less favourable position on account of the implementation of the examinership procedure compared to the position they would have been in if the entity was, instead, put into liquidation.

22. How does the start of insolvency procedures affect a lender's rights to enforce its loan, guarantee or security?

The impact of the initiation of insolvency procedures on the lender's right to enforce primarily depends on the type of security that the lender has over the assets of the insolvent entity.

It is usual for the commencement of an insolvency procedure to be included in an agreement as an event of default that triggers the termination and enforcement procedures set out under the agreement.

Where a winding-up order has been made or where a provisional liquidator has been appointed, the liquidator or the provisional liquidator, as the case may be, takes into his or her custody or under his or her control all the property and things in action to which the company is or appears to be entitled to.

A secured creditor should, within the prescribed period, submit to the official receiver or liquidator or guarantor, where applicable, a preliminary valuation of the secured asset and agree with these persons on valuation. If no agreement is reached on the value, an independent valuer can be appointed.

In addition, the court can set a deadline by which creditors must prove their debts or claims. Creditors will be excluded from the benefit of any distribution made before those debts are proved. The proof will set out whether the creditor is a secured creditor or not.

Any distribution of property of the company, including things in action and any transfer of shares, or change in the status of the members of the company which is effected after the initiation of the winding-up is void, unless the court orders otherwise.

In addition, when a company is being wound up by the court, any attachment, sequestration, distress or execution against the estate or objects of the company after the commencement of the winding-up will be deemed void.

It is also possible for stays to be imposed on actions or proceedings against the company. At any time after the presentation of a winding-up petition, and before a winding-up order has been made, the company, or any creditor or contributory, can apply to the court in which the action or proceeding is pending and request for a stay of proceedings, as well as to restrain from further proceedings.

Once a winding-up order has been issued and a provisional liquidator has been appointed, no action or proceeding can be continued or commenced against the company, unless by leave of the court.

On an application by the official receiver or liquidator, the court can also order that secured assets be taken into the receiver's or liquidator's custody and be liquidated as if they were not charged. In this case, the security holder will have the same priority with respect to any other analogous assets of the company as it would have had.

23. What transactions involving loans, guarantees, or security interests can be made void if the borrower, guarantor or security provider becomes insolvent?

Where a company goes into liquidation, any conveyance, charge, mortgage, delivery of goods, payment, execution or other act relating to property that took place within a period of six months of the commencement of the winding-up may be considered as a fraudulent preference and be set aside. A preference is considered fraudulent if it is intended to put a creditor in a better position in the event of liquidation of the company than he or she would have been without such action. All creditors who benefited from a fraudulent preference must repay any benefit they obtained. Where a transaction constitutes a financial collateral arrangement within the meaning of the Financial Collateral Arrangements Law, 43(I)/2004, the arrangement will not be deemed void if it has come into existence, or the financial collateral has been provided, on the day of the commencement of the winding-up proceedings or reorganisation measures, or within a prescribed period before then.

In addition, when a company is in liquidation, a floating charge that was created within 12 months from the commencement of the winding-up is void, unless it is proven that the company was solvent immediately after the creation of the charge.

Lastly, where the requirement to register a charge is not complied with, this will result in the charge being considered void as against the liquidator and any creditor of the company. However, the security will remain valid and enforceable as between the chargor and the chargee.

24. In what order are creditors paid on the borrower's insolvency?

Claims of creditors are satisfied in accordance with a priority ranking set out in the Companies Law, Cap. 113, as amended. The order of distribution of assets on a winding-up is as follows:

- Where there is a fixed charge, the net proceeds from the sale of secured assets will primarily be used for the settlement of amounts secured by the charge (provided that, where the charge must be registered in accordance with the Companies Law to be valid as against the liquidator, the registration has been duly effected, otherwise the claims will rank *pari passu* with those of unsecured creditors). If there is a surplus from the sale of the secured assets subject to the charge, the surplus becomes part of the general pool of assets and is distributed in accordance with the below priority list. If there is a shortfall, a secured creditor will be deemed to be an unsecured creditor only with respect to this shortfall and will rank after the costs of the winding-up, preferential debts and any floating charge holders, *pari passu* with all the other unsecured creditors. The ranking between fixed charge holders is determined by the timing of the registration of the charge with the Registrar of Companies. Provisions in inter-creditor or subordination agreements may also have an impact on priority. The obligations under an unperfected charge that is registrable will not be recognised by the liquidator as secured obligations, but instead will constitute unsecured obligations and will rank together with unsecured creditors.
- Costs and expenses of the winding-up.
- The following preferential debts (which rank equally among themselves and are paid in full, unless the assets are insufficient to meet them, in which case they abate in equal proportions):
    - rates and taxes, and all government taxes and duties due from the company;
    - any salary owed to an employee and any sum withheld by the employer from the employee's salary for the payment of any obligations of the employee or otherwise, that the employer has not paid, and any other sum or employee benefit that arises as a result of an agreement or employment relationship;
    - any amount of compensation that the company must pay to an employee on account of bodily harm suffered by the employee as a result of an accident caused by his or her employment and during his or her employment with the company; and
    - any amount due to the employee in relation to the leave to which this employee is entitled to in his or her employment with the company, up to a one-year employment period.
- Any amount secured by a floating charge.
- 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.

Additionally, set-off and netting (which are both forms of quasi-security) of mutual obligations between two parties is generally recognised and protected under Cyprus law. Therefore, certain assets or amounts of the entity in liquidation which would otherwise form part of the pool of assets and distributed in accordance with the above priority list will, depending on the circumstances, be set off or netted with any obligations owing to the entity in liquidation.

Cross-border issues on loans

25. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders?

There are no restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders.

26. Are there exchange controls that restrict payments to a foreign lender under a security document, guarantee or loan agreement?

There are no restrictions on payments to a foreign (non-Cypriot) lender under a loan agreement or security document, including a guarantee. There are no exchange control restrictions on the enforcement of guarantees, although a guarantee may be subject to stamp duty.

Since 6 April 2015, there have been no temporary restrictive measures imposed under the Enforcement of Restrictive Measures on Transactions in case of Emergency Law No 12(I) of 2013. The last orders issued by the Minister of Finance following the banking crisis of March 2013 have expired and have not been renewed. Further, the Movement of Capital Law No 115(I) of 2003 ensures that there are no restrictions to the movement of capital, including payments to and from residents of Cyprus and residents of the EU or third countries.

Taxes and fees on loans, guarantees and security interests

27. Are taxes or fees paid on the granting and enforcement of a loan, guarantee or security interest?

Documentary taxes

Cyprus Stamp Duty Law No 19/1963, as amended, imposes stamp duty on all documents (including contracts) concerning property or proprietary rights situated in Cyprus or concerning things or matters to be executed in Cyprus or to take place in Cyprus (subject to certain exceptions), regardless of where the document is signed.

Stamp duty rates for contracts in general are as follows:

- EUR0 to EUR5,000: nil.
- EUR5,001 to EUR170,000: 0.15%.
- Over EUR170,000: 0.20%.

Stamp duty for assignment contracts relating to trade marks and patents is:

- EUR1 for every EUR200, on the amount of the consideration.
- EUR18 when there is no consideration.

Stamp duty for a transfer of lease by assignment (not by sublease) is:

- EUR9, when there is no consideration.
- The same as for general contracts otherwise (*see above*).

The maximum amount of stamp duty payable is EUR20,000. For a transaction involving several documents, the parties can choose which document is the main document. Only the main transaction document will be subject to the full stamp duty. The other transaction documents will be stamped as secondary documents, carrying stamp duty in the amount of EUR2 each.

Late payment of stamp duty will result in penalties, which range according to the period that elapsed between the date the stamp duty arose and the date of submission of the documents to the Stamp Duty Commissioner for stamping.

Registration fees
The registration fees that apply in Cyprus are as follows:

- Registration of a charge will incur the payment of filing fees of about EUR680 per charge registered. This covers the EUR600 filing charge, EUR40 stamps on the form HE24 and EUR40 for the issuing of the certificate of registration in the Greek and English languages (*section 90, Companies Law, Cap. 113, as amended*).
- A legal mortgage over immovable property requires registration with the relevant district land office. Registration fees of 1% of the amount secured are payable (*Transfers and Mortgages Law, No 9/1965*).
- A mortgage over a vessel or any shares in a vessel is registered with the Department of Merchant Shipping, with registration fees dependent on the gross tonnage of the vessel (EUR0.034172 per gross tonne for the first 10,000 tonnes and half that rate above 10,000 tonnes) (*Merchant Shipping (Registration of Ships, Sales and Mortgage) Law, No 45/63, as amended*).

Notaries' fees
Not applicable.

28. Are there strategies to minimise the costs of taxes and fees on the granting and enforcement of a loan, guarantee or security interest?

As fees are nominal (with perhaps the exception of stamp duty), there are not usually any strategies to minimise the cost of taxes and fees.

As mentioned in *Question 20*, share pledges can be enforced automatically out of court through the use of pre-delivered documents. If a complete and valid set of deliverables is available, this reduces the enforcement costs significantly as no recourse to the court is required.

Reform

29. Are there any proposals for reform?

There are currently no proposals for reform. Cyprus's highly competitive environment in lending and taking security is one of the key factors that helped the country to quickly overcome the banking crisis and to attract foreign investment. The law does not discriminate between Cyprus and foreign creditors. The secured lending market, as far as corporate borrowers are concerned (that is, Cyprus companies with foreign interests, especially those holding assets out of Cyprus either directly or indirectly through subsidiaries), remained strong and was least affected by the financial crisis.

Online resources

CyLaw
W *www.cylaw.org*

Description. This website is maintained by the Cyprus Bar Association and contains up-to-date legislation, case law, regulations and procedure rules (in Greek only).

Department of the Registrar of Companies
W *www.mcit.gov.cy/mcit/drcor/drcor.nsf/index_en/index_en?OpenDocument*

Description. This is the official website of the Department of the Registrar of Companies (available in Greek, English and Turkish).

Legislation Commissioner
W *www.olc.gov.cy/olc/olc.nsf/dmlindexa_gr/dmlindexa_gr?OpenDocument*

Description. This is the official website of the Legislation Commissioner. Some official translations of legislation can be found on the website. The official translation of the Companies Law can be found at the following link: *www.olc.gov.cy/olc/olc.nsf/All/E1EAEB38A6DB4505C2257A70002A0BB9?OpenDocument&highlight=113*.

Department of Lands and Surveys
W *http://portal.dls.moi.gov.cy/en-us/Rights%20and%20Fees/Pages/default.aspx*

Description. This is the official website of the Department of Lands and Surveys.

Department of Merchant Shipping
W *www.mcw.gov.cy/mcw/dms/dms.nsf/feesship_en/feesship_en?OpenDocument*

Description. This is the official website of the Department of Merchant Shipping.

Contributor profiles

Lia Iordanou Theodoulou, Partner – Head of Corporate Finance

Patrikios Pavlou & Associates LLC

T +35725871599
F +357344548
E *liordanou@pavlaw.com*
W *www.pavlaw.com*

Professional qualifications. LLB, University of East Anglia, Norwich, UK; Barrister, Gray's Inn, London, UK

Areas of practice. Corporate finance, ship finance; corporate and M&A; restructuring and insolvency; financial law; foreign investment; commercial law; trusts and asset protection.

Languages. Greek (mother tongue), English (fluent), French (basic)

Professional associations/memberships. Honourable Society of Gray's Inn; International Bar Association; English Bar Association; Cyprus Bar Association; Society of Trusts and Estate Practitioners (STEP).

Publications. Recent publications include:

- Co-authored "*Restructuring & Insolvency - Cyprus Chapter", Getting the Deal Through, The Law Business Research Ltd (2016, 2017).*
- Co-authored *"The Cyprus International Trust" (2016).*
- *Legal memo on Cyprus tax resident non-domiciled status (2015).*
- Co-authored *"Updated Cyprus Real Estate Investments Schemes", Corporate LiveWire, (2015).*
- Co-authored *"Securities Finance - Cyprus", Getting the Deal Through, (2007/2008/2009/2010).*

Angeliki Epaminonda, Senior Associate, Corporate Finance Department

Patrikios Pavlou & Associates LLC

T +35725871599
F +35725344548
E *aepaminonda@pavlaw.com*
W *www.pavlaw.com.cy*

Professional qualifications. Admitted to the Cyprus Bar, 2010; Legal Practice Course, Kaplan Law School, London, UK; LLB, Keele University, UK

Areas of practice. Corporate law and M&A; restructuring and insolvency; financial law; corporate finance; commercial law.

Languages. Greek (mother tongue), English (fluent), French (basic), Italian (basic).

Professional associations/memberships. Cyprus Bar Association.

Publications

- Co-authored *"Restructuring & Insolvency - Cyprus Chapter", Getting the Deal Through, The Law Business Research Ltd (2016).*
- Co-authored *"The Corporate Governance Review - Cyprus Chapter", The Law Reviews, Law Business Research (2015&2016).*
- Co-authored *"The International Comparative Legal Guide to: Corporate Governance - Cyprus", Global Legal Group (2012/2013/2014).*

Elena Georgiou, Senior Associate, Corporate Finance Department

Patrikios Pavlou & Associates LLC

T +35725871599
F +35725344548
E *egeorgiou@pavlaw.com*
W *www.pavlaw.com.cy*

Professional qualifications. Admitted to the Cyprus Bar, 2011; LLM, King's College London, UK; LLB, University of Kent, UK

Areas of practice. Corporate law and M&A; financial law; corporate finance; commercial law.

Non-professional qualifications. Chartered Institute for Securities & Investment (CISI), Certificate in Corporate Finance: Corporate Finance Technical Foundations

Languages. Greek (mother tongue), Slovak (mother tongue), English (fluent), Spanish (basic)

Professional associations/memberships. Cyprus Bar Association membership; Chartered Institute for Securities & Investment (CISI) membership.

Publications

- Co-authored *"The International Comparative Legal Guide to: Corporate Governance - Cyprus", Global Legal Group, (2012/2013/2014).*
- Co-authored *"Obtaining Republic of Cyprus Permanent Residence or Citizenship by Investment - Updated Incentive Schemes" – 2014.*
- Co-authored *"Company Formations In Cyprus", Lawyer issue, 2015.*

Georgia Kampanelli, Advocate – Legal Consultant, Corporate Finance Department

Patrikios Pavlou & Associates LLC

T +35725871599
F +35725344548
E *gkampanelli@pavlaw.com*
W *www.pavlaw.com.cy*

Professional qualifications. Admitted to the Cyprus Bar, 2015; Master of Laws in Legal Theory, London School of Economics and Political Science, UK; LLB, Queen Mary University of London, UK

Areas of practice. Corporate law and M&A; corporate finance; commercial law; banking litigation.

Languages. Greek (mother tongue), English (fluent)

Professional associations/memberships. Cyprus Bar Association.

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Country Q&A
Restructuring and insolvency in Cyprus: overview•Law stated as at 01-May-2017

Tax on corporate transactions in Cyprus: overview•Law stated as at 01-Aug-2016

