**LEGAL ISSUES TO BE NOTED WHEN**

**CONVERTING LOANS INTO CONTRIBUTED CAPITAL**

In recent years, in Vietnam, to increase the capital for business operations, expansion of investment projects, many companies have chosen to raise capital by borrowing capital from many different sources. In addition to domestic loans, companies have found ways to access and borrow capital abroad through foreign loans. One of the sources of foreign loans that companies often approach and apply to raise capital is borrowing capital from the parent company, or investors who are existing shareholders/members/owners of the company, or another lender who is not a shareholder/member/owner of the company (“**Lender**”). Currently, this is considered one of the most effective forms of capital raising on both effectiveness and cost. For loans that the Vietnamese Company (“**Borrower**” or “**Company**”) borrows from overseas Lenders, there are commonly repayment options as follows:

1. The Borrower pays the loan with interest for the Lender as agreed in the Loan Contract;

1. If the Borrower is unable to repay the debt but the parties agree to prolong the payment term; or

1. The Lender will convert this loan into contributed capital in the Company to increase charter capital if the parties agree on a plan to convert the loan into contributed capital.

In this article, we will discuss option (3) – Converting foreign loans into contributed capital and outline some issues that we need to give attention to. In fact, debt settlement by conversion into capital contribution has partly helped companies reduce financial burden, solve difficulties on the verge of bankruptcy and recover production and business activities, typical cases are as follows: Sadico Can Tho, Kon Tum Sugar Joint Stock Company, Binh An Seafood Joint Stock Company…

**What is the conversion of loans into contributed capital?**

Converting the loan into a capital contribution is the fact that the Lender, instead of recovering the debt lent to the Company, will use that debt to "buy" the shares/ capital contribution of the Company. After that process, the Lender will become the owner/shareholder/member of the Company.

Currently, the current legal regulations do not have any provisions prohibiting the conversion of loans into contributed capital, and there are no specific instructions on this conversion process. In essence, the conversion of the loan into contributed capital is a way to increase the company's charter capital to equal the old charter capital plus the converted loan. The difference is that the money transfer has been completed before the company decided to increase capital. At the same time, in case of the Lender is not a shareholder/contributor of the Company, this conversion will make the Company have new shareholders/contributors and the capital ratio of the foreign shareholders/members will be increased. Therefore, depending on the type of business operating, the Company needs to have the acceptance/approval of the General Meeting of Shareholders, Member’s Council, and the Owner before carrying out the conversion.

On the other hand, debt repayment by shares/contributed capital is clearly specified in Clause 2, Article 34 of Circular 03/2016/TT-NHNN, one of the forms of debt repayment without using a loan, foreign debt payment account is “*Paying debt by shares or contributed capital of the borrower in accordance with the provisions of law*”. This regulation has clearly confirmed and created an important legal basis for converting foreign debt into shares/contributions. Therefore, the Lender who is a foreign investor can completely transfer the borrowed debt to the contributed capital in the Company.

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#### Conditions for converting foreign loans into contributed capital

Some basic conditions should be noted by the Borrower and the Lender, including:

* Prove the legitimacy of the Loan Agreement signed by the parties;

* If the foreign loan is a medium-term or long-term loan, the Borrower must register the loan with the State Bank (“**SBV**”). Short-term loans must be reported to the State Bank;

* The loan is properly transferred to the Direct Investment Capital Account (“**DICA**”) or the Loan Account of the Company as required by law;

* After conversion, the Lender's capital contribution ratio must comply with the limit prescribed by law.

**What should be done to convert foreign loans into contributed capital?**

To convert foreign loans into contributed capital, the Company needs to carry out procedures required under laws on investment, enterprise, and foreign exchange. The order to convert foreign loans into contributed capital of the Company as follows:

**Firstly**, the parties need to make a written agreement or contract on converting this loan into contributed capital. These documents should clearly state the time, the amount of conversion, the plan to handle interest and principal or late payment penalty interest, the percentage of capital that the Lender will own after completing the conversion procedure in the Company, etc.

**Secondly**, the parties need internal approvals to the conversion of the loan into contributed capital, increase in charter capital, the addition of new members/shareholders (if any), the change of holding ratio of contributed capital/shares, etc.

**Thirdly**, the parties need to carry out administrative procedures at competent state agencies to increase charter capital and record new shareholders/contributors (if any):

* *Step 1: Carry out procedures for approval of capital contribution/share purchase/contribution of foreign investors at the Department of Planning and Investment*

After receiving and reviewing the dossier, if the Company and the Lender fully satisfy the conditions as prescribed by laws, the Department of Planning and Investment will issue a Document on meeting the conditions for capital contribution/share purchase/capital contributed by foreign investors in which specifies the expected charter capital after the increase, the contributed capital and capital contribution ratio of the Lender.

* *Step 2: Notice of changing the content of Enterprise registration, including:* *the change of charter capital, capital contribution ratio, information of members/shareholders of foreign investors*

Within 10 working days from the date of completing the conversion of the loan into contributed capital and increasing the charter capital, the Company must carry out procedures to change the content of the Business Registration Certificate at the Department of Planning and Investment.

In fact, the Department of Planning and Investment usually does not concern and has no obligation to check the origin of the additional charter capital. Therefore, the Company being granted Enterprise Registration Certificate adjusting and adding the new charter capital does not mean that the origin of the additional capital contribution/conversion of loans into capital is in accordance with the provisions of law.

* *Step 3: Notice of changing in the content of Investment Registration Certificate (if any,) including: the change of investment capital for project implementation, information of foreign investors*

Please note that the procedure for increasing investment capital for project implementation and changing foreign investor information in the Investment Registration Certificate can be done before changing the Enterprise Registration Certificate.

* *Step 4: Notice of paying debt by shares/capital contribution to the SBV*

#### **For short-term foreign loans: The Company needs to report to the SBV regarding converting loans into investment capital through traditional or electronic forms as prescribed.**

#### **For medium and long-term foreign loans: The Company needs to notify in writing the bank providing the account service about the payment of the debt by converting the loan into capital contribution, no need to register loan changes with the SBV.**

**Fourth**, the Company receiving foreign capital needs to pay more attention to the investment and business conditions prescribed by laws to ensure that foreign investors fully meet the conditions as prescribed by laws and the Company fully meets the conditions for doing business.

Above are some regulations on the order, procedures and issues related to the conversion of loans into contributed capital that the Company should be noted, but in fact, state agencies may have different requirements depending on each province. In addition, converting loans into contributed capital is also subject to many legal regulations in the specialized field. Therefore, in the process of negotiating and implementing conversion procedures, the Company should have support and advice from law firms that are knowledgeable in this field to minimize potential risks.