

# UNIQUE ASPECTS OF JAPANESE SECURITIZATION RELATING TO THE ASSIGNMENT OF FINANCIAL ASSETS

## A COMMENT ON RAINES & WONG

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The validity of an assignment of financial assets to be securitized can be crucial in the event of the bankruptcy of the originator of the assets. In international securitization transactions, the local jurisdiction of the originator will be important in examining the validity of the assignment. Accordingly, in this comment, I would like to briefly analyze some of the same issues discussed in *Aspects of Securitization of Future Cash Flows Under English and New York Law*,<sup>1</sup> relating to the transfer of financial assets, particularly future receivables, as those issues would relate to financial assets originated by a Japanese company. This comment will first examine the question of whether a future receivable may be assigned in Japan, and will go on to consider how such an assignment should be perfected. It concludes with a brief discussion of risks relating to the bankruptcy of the originator.

Although the United Nations Commission on International Trade Law (UNCITRAL) has taken the position that the law governing the validity of an assignment with respect to third parties should be dictated by the law of the jurisdiction of the creditor (originator),<sup>2</sup> Japanese law does not follow this approach. Japanese con-

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1. Marke Raines & Gabrielle Wong, *Aspects of Securitization of Future Cash Flows Under English and New York Law*, 12 DUKE J. COMP. & INT'L L. 453 (2002).

2. See United Nations Convention on the Assignment of Receivables in International Trade, *opened for signature* Dec. 12, 2001, G.A. Res. 56/81, U.N. GAOR, 56th Sess., ch.V, Autonomous Conflict-of-Laws Rules, U.N. Doc. A/RES/56/81 (2002), *available at* <http://www.uncitral.org/stable/res5681-e.pdf> (last visited Mar. 5, 2002); United Nations Convention on the

flict-of-laws principles require that the law of the jurisdiction of the debtor control the determination of the validity of an assignment in relation to interested third parties. For this reason, in this comment, it should be assumed that both the originator, as the creditor, and the debtor are Japanese companies such that Japanese law will govern for all purposes.

As a preliminary matter, I would like to preface the ensuing discussion by offering a brief background on the concepts of “receivables” and “future cash flows” in Japan. Under Japanese law, receivables, whether existing or future, are viewed as simply a type of contractual right or obligation, such as a payment obligation or monetary claim, and thus, the legal analysis applicable to an assignment of receivables is technically the same as that of an assignment of contractual rights. The concept of receivables does not encompass payments made on that contractual obligation, only the obligation itself. Similarly, when discussing “future cash flows” under Japanese law, the legal concept of future cash flows merely means a future monetary claim on the eventual payment of receivables that will arise, become effective, or be incurred on a future date. Thus, once receivables are paid, the assignee’s claim is no longer a contractual claim for payment but rather a claim on the paid amounts themselves, and the focus of the legal analysis shifts from contract rights (with respect to the receivable) to property rights (on the cash proceeds of the receivable). Though there is no compelling reason that the proceeds of receivables should be treated differently from the receivables themselves, Japanese law continues to view these concepts as distinct. This conceptual clarification is important to understanding the nuances of securitizations in Japan. For example, because cash proceeds are governed by property principles, special consideration must be given to the possibility of the originator becoming subject to insolvency proceedings, requiring that steps be taken to ensure that the proceeds of securitized receivables are adequately accounted for. Depending on the circumstances, such steps may include terminating the service agreement or obtaining court approval of an agreement among the parties and the insolvency trustee regarding the handling of proceeds of securitized receivables.

Japanese law allows the assignment of future receivables, and such assignment is deemed effective immediately as of the date of the assignment rather than the date on which the receivables are actually

created. For example, in the case of a future sale of goods, an assignment of receivables on the prospective sales would take place immediately, while a conceptual assignment of the receivables would be understood to arise automatically upon the eventual consummation of the sale of those goods.

Until recently, courts had imposed a one-year time limitation on the validity of an assignment of future receivables, thereby restricting the securitization of future cash flows in Japan. For any receivables payable beyond that one-year period, further assignments had to be made from time to time. However, on January 29, 1999, the Supreme Court of Japan effectively negated this one-year time limitation by allowing an assignment of future receivables for a term ending eight years from the initial date of assignment, provided that the future receivables were sufficiently identified with respect to the commencement and the termination of the period during which the receivables were assigned.<sup>3</sup> In that case, the Supreme Court upheld the validity of a physician's assignment of medical fee receivables to be generated over an eight-year period as security for the physician's lease of certain medical equipment. Although this case involved the assignment of assets as security, legally speaking, there is no difference under Japanese law between an absolute assignment and an assignment for security purposes in assessing the validity of an assignment of future receivables. As a result, this 1999 case has been viewed as a substantial breakthrough in the securitization of future cash flows in Japan.

In Japan, the most important aspect relating to the assignment of receivables, whether existing or future, is the perfection thereof. Without perfection, an assignment is only valid between the assignor (originator) and the assignee (special purpose vehicle) but not valid in relation to the debtor or in relation to other interested third parties, including a subsequent assignee or a bankruptcy trustee of the assignor. Perfection issues become most acute in securitizations in the event of the bankruptcy of the originator. Accordingly, the perfection of an assignment of receivables, whether existing or future, merits close attention in the practice of securitization in Japan.

In Japan, there are two different types of perfection: perfection in relation to a debtor and perfection in relation to other interested third parties (including, perhaps most importantly, a bankruptcy trustee). The latter type of perfection has proven to be of greater impor-

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3. Kyōtakukin kanpu seikyūken kakunin seikyū jiken [Case requesting to declare the existence of the right to retrieve the deposit], 53 MINSHŪ 1, 151 (Sup. Ct., Jan. 29, 1999).

tance to securitizations in Japan. As discussed below, the perfection of receivables, whether existing or future, in Japan may be accomplished immediately at the time of assignment.

Under the Japanese Civil Code, to perfect the assignment of a contractual right, including receivables (whether existing or future), with respect to interested third parties, the assignor is required either to deliver proper notice or to obtain necessary consent; in either case, the assignor must take steps to ensure that the foregoing documents bear officially certified dates (*kakutei hizuke*). Prior to 1998, delivering such notice was an extremely expensive and burdensome endeavor, and such notice requirements alone were once considered to be a major obstacle in Japanese securitizations. Companies typically satisfied the Civil Code requirements by sending notice by certified mail accompanied by a certificate of receipt. Consequently, securitizations of large pools of financial assets involving thousands of monetary claims were once impeded by massive mailing costs, time delays and the inconvenience suffered by debtors. In 1993, the government facilitated the securitization of specific types of financial assets, most notably auto loans and lease receivables, with the passage of the MITI Securitization Law, which allowed the perfection of assignments of assets in relation to both debtors and third parties to be accomplished through the publishing of public notice in a newspaper.<sup>4</sup>

Broader change was achieved through further changes to the notice requirements in 1998, with the passage of the Perfection Law,<sup>5</sup> which enabled companies to perfect the assignment of monetary claims in relation to third parties generally by filing a simple electronic registration with the Legal Affairs Office of the Japanese government. The law allowed the perfection of assignments of large pools of financial assets to be accomplished easily through the one-time filing. Although the MITI Securitization Law is still valid, it has become somewhat obsolete and is not often used because assignments governed by the law are now also covered by the Perfection Law. Thus, at this time, nearly all securitizations of financial assets are made in reliance on the 1998 Perfection Law.

In conclusion, I would like to touch upon the issue of whether an assignment of financial assets will be treated as a “true sale” under

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4. Tokutei saikentō ni kakaru jigyō no kisei ni kansuru hōritsu [Law concerning the restrictions of business relating to specified claims, etc.], Law No. 77 of 1992.

5. Saiken jōto no taikō yōken ni kansuru minpō no tokureitō ni kansuru hōritsu [Law prescribing exceptions, etc., to the civil code requirements for setting up against a third party to an assignment of claims], Law No. 104 of 1998.

Japanese law. True sale analysis under Japanese law of the risk of an assignment being recharacterized as a secured loan appears similar to the analysis utilized in common law countries. Although there is a dearth of judicial guidance in Japan for distinguishing an assignment as a true sale from one made for security purposes, in practice certain criteria have been relied upon in establishing true sale status. These criteria include the intent of the parties, the transfer of risk and benefit, the payment of a proper purchase price, the level of control exerted by the purchaser over the assets, and the absence of a purchase option or repurchase obligation by the assignor.

Arguably, the practical risk of failing to achieve a true sale in Japan may be low where the parties have taken appropriate steps to address such risk. Recently, two large non-bank companies that had securitized lease receivables and auto loans respectively, went bankrupt and became the subject of corporate reorganization proceedings.<sup>6</sup> No challenges to the true sale nature of these companies' securitization transactions were made by their respective corporate reorganization trustees. Consequently, there has been greater certainty with respect to subsequent securitizations of financial assets in Japan as companies are better able to structure their transactions in such a manner as to minimize risks associated with challenges to true sale.

Such advanced planning is crucial to accomplishing a successful securitization in Japan. The issues discussed in this comment illustrate some of the unique aspects of Japanese law relating to the assignment of financial assets that thus merit special consideration by practitioners and pose important implications for negotiating and structuring securitization deals in Japan.

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6. On September 27, 1998, Japan Leasing Corporation, one of the largest leasing companies in Japan, filed a corporate reorganization petition with the Tokyo District Court. Its total debt burden was 2,200 billion yen, the largest insolvency case in Japan at the time. *Nihon Rīsu Kōseiho Shinsei [Japan Leasing Files for Corporate Reorganization]*, NIHON KEIZAI SHIMBUN Sept. 28, 1998, at 1. Further, on May 19, 2000, LIFE Co., Ltd., one of the largest credit companies in Japan, filed a corporate reorganization petition with the Tokyo District Court. Its total debt burden was nearly 970 billion yen. *Raifu Kōseiho Shinsei [Life Files for Corporate Reorganization]*, NIHON KEIZAI SHIMBUN May 20, 2000, at 1.