

THE SECURITISATION  
LAW REVIEW

FOURTH EDITION

Editor  
Michael Urschel

THE LAWREVIEWS

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**Editor**  
Michael Urschel

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PUBLISHER

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# PREFACE

Securitisation, broadly defined as the conversion of assets into marketable financial securities, has been used as a method of raising capital since as early as the 1970s in the United States. The use of securitisation as a form of borrowing has increased globally since then, and bodies of law have been established in many jurisdictions to allow borrowers to access capital in this manner, while protecting potential investors. Regulatory considerations include tax structuring, bankruptcy considerations and economic-driven regulation focused specifically on securitisation.

Securitisation regulatory frameworks have developed at different rates globally and largely depend on a variety of factors, including the economic state of a given jurisdiction, the broader legal frameworks already in existence (including tax and bankruptcy law), particular asset classes available to securitise and habits of local consumers. Although certain assets, such as mortgage loans, are frequently securitised across many jurisdictions, other asset classes can vary. For example, in the United States and many developed countries, in addition to mortgage loan securitisation, securitisation of automobile loans and consumer debt is extremely common, and significant expansion into other operating assets such as leases and royalties is occurring. In certain other countries, more purpose-driven and asset-class specific monetisation transactions are relevant. Economic events, such as the 2008 recession in the United States, have had a great impact on the regulatory framework, not only in the United States, but also in jurisdictions such as Japan that were affected by the recession, and the effects of the covid-19 pandemic and have led to certain government responses in bolstering the securitisation market. Although 2020 and 2021 were robust years for the securitisation markets, with increased deal volume and substantial innovation in the asset class across the globe, we are currently witnessing the securitisation market's reaction to multiple macroeconomic events, such as global inflation and the recent conflict in Ukraine.

In this fourth edition of *The Securitisation Law Review*, we aim to provide securitisation attorneys, borrowers, lenders and other market participants with insight into a sample of structural frameworks and regulatory issues surrounding the industry in a broad array of jurisdictions. This volume is not intended to be a comprehensive overview of securitisation regulation and structures in every jurisdiction, but rather to provide a frame of reference for, and a comparison of, the various structural features available and the regulatory considerations necessary in securitising assets globally. As the asset securitisation industry continues to develop and expand to new and more esoteric asset classes, such a comparison will undoubtedly be useful to those innovating in global securitisation markets.

I would like to thank the contributors for the chapters that follow. I hope that this volume will produce grounds for continued discussion in the global securitisation industry.

**Michael Urschel**

King & Spalding LLP

New York

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# JAPAN

*Kazunari Onishi, Hikaru Naganuma and Saori Kakishita*<sup>1</sup>

## I OVERVIEW

### i Recent trends of the Japanese securitisation market

After weathering the 2008 Lehman crisis and the Great East Japan Earthquake in 2011, the Japanese securitisation market saw a robust recovery. The outbreak of the covid-19 pandemic in 2020, however, disrupted the positive trend. The pandemic triggered a voluntary market lockdown in April 2020, with the declaration of a state of emergency that lasted till the end of May 2020. In 2021, the declaration of a state of emergency was issued three times during the period from January to September. The Japanese economy experienced severe damage as a result. As of July 2022, the covid-19 pandemic is still casting a shadow over the Japanese economy, as the government has had to take several countermeasures to battle fresh waves of infections, including limits on the number of people entering Japan and entreaties for self-isolation. The border restrictions in Japan are being gradually relaxed, but general tourism is not allowed yet.

The Japanese securitisation market, similarly, was not spared, as many transactions were temporarily suspended in light of the socio-economic uncertainties that followed the onset of the covid-19 pandemic. However, the market is now seeing a steady recovery as an increasing number of domestic and overseas investors with surplus funds seek investment opportunities. This investment demand has also propped up the price of real estate in Japan, particularly in urban areas.

According to a survey conducted by the Japan Securities Dealer Association and Japanese Bankers Association,<sup>2</sup> the outstanding balance of securitisation products in fiscal year 2022 was approximately ¥25,590.3 billion, up 3.8 per cent from fiscal year 2021. Looking at the underlying assets, residential mortgage-backed securities (RMBS) accounted for 84.3 per cent (¥21,584 billion) in absolute terms, with ‘shopping credits’ accounting for 7.8 per cent (¥1,995.6 billion). Among the RMBS products, Japan Housing Finance Agency mortgage-backed securities accounted for 70.3 per cent (¥15,167 billion).

Focusing on securitisation of real estates, another survey conducted by the Ministry of Land, Infrastructure, Transport and Tourism (MLIT)<sup>3</sup> shows that the amount of acquisitions

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1 Kazunari Onishi and Hikaru Naganuma are partners and Saori Kakishita is an associate at Anderson Mōri & Tomotsune.

2 Securitisation Market Trends Survey Report (Issuance Trends in Fiscal 2022) published on 31 July 2022.

3 Factual Investigation of Real Estate Securitisation for Fiscal Year 2021.

of securitised real estate (including acquisitions by J-REITs but excluding private funds) in fiscal year 2021 was approximately ¥2.4 trillion, which was a slight increase from fiscal year 2020, in which the acquisition amount was ¥2 trillion.

The impact of the covid-19 pandemic is still bearing down on the Japanese economy, and the securitisation market in Japan is expected to experience significant uncertainties in 2022 and beyond. The Tokyo 2020 Olympic Games were expected to boost inbound tourism. However, the Games were postponed by a year and eventually held with no spectators; it is still unclear when tourism levels will go back to normal. These circumstances have adversely affected the earnings forecast of hotel properties. Moreover, the pandemic has given rise to the prevalence of teleworking and redefined working environments, which could have a huge impact on demand for office space and rent levels in urban areas. In addition, as companies and consumers shift to cloud-based internet services and online retailing, data centre facilities are attracting more interest from both of investors and debt finance providers.

## ii Common structures for securitisation

In Japan, the most commonly used forms of securitisation are as follows:

- a the GK-TK structure;
- b the TMK structure; and
- c the trust structure.

Each of the foregoing structures has been adopted by investors for the purposes of assuring bankruptcy remoteness and tax benefits.

The GK-TK structure has mainly been utilised for securitisation of real estate properties. Under the GK-TK structure, a *godo kaisha* (GK), which is one of the corporate forms available under the Companies Act of Japan, having similar features to a limited liability company, is selected as a special purpose vehicle (SPV) holding the target assets. The GK is financed by way of loans or *tokumei kumiai* (TK) investments under the Commercial Code of Japan, in an arrangement whereby TK investors form a silent partnership to conduct the GK's business. TK investors are entitled to tax benefits by deducting the amount of distributed profits from the GK's taxable income as expenses (see Section II.ii). The GK's assets, including trust beneficiary interests (TBIs) and account receivables, are provided as collateral in favour of lenders. The GK has the merit of being a flexible corporate structure with stability in bankruptcy as it is not subject to the Corporate Reorganisation Act of Japan, which may restrict security holders' rights in corporate rehabilitation proceedings. In a typical scenario, the assets are entrusted by an originator to a trustee and the GK acquires the TBIs because the GK has to obtain governmental approval for operating the business of real estate-specified joint enterprises under the Real Estate Specified Joint Enterprise Act of Japan (RESJEA) if it accepts TK investments and utilises such investments for the acquisition and (self-management) of real estate property. However, amendments to the RESJEA in 2013 and 2017 introduced certain exemptions that allow an SPV to engage in a real estate-specified joint enterprise by filing a notification with the MLIT, rather than obtaining governmental approval, subject to certain conditions being fulfilled. This exemption has been utilised recently, but the TBI structure is still prevalent because taxes are not imposed on the transfer of TBIs.

In a TMK structure, a *tokutei mokuteki kaisha* (TMK) is utilised as an asset-holding vehicle. A TMK is an SPV introduced by the Japanese Act on Asset Securitisation (the Securitisation Act) in 1998 to facilitate asset securitisation. Prior to the commencement

of business, a TMK is required to file with the relevant local finance bureau a business commencement notification and an asset liquidation plan (ALP), which is the constitutional document of a TMK. A TMK is typically financed by specified bonds, loans or preferred shares. A TMK enjoys various tax benefits, including preferential rates of real estate acquisition tax and real estate registration tax, as well as the deduction of distributed profits from its taxable income, subject to the satisfaction of certain 'tax-conduit' requirements. For a TMK to meet the tax-conduit requirements, 75 per cent of its asset portfolio must consist of real estate-related properties. In this context, the TMK structure is mainly utilised for securitisation of real estate properties. A TMK is subject to supervision by the Financial Services Agency of Japan (FSA) and the scope of its business is restricted to that set out in the ALP.

In a typical trust structure, an originator entrusts its assets with a trustee and includes TBIs in the entrusted assets. TBIs are divided into the senior portion that is sold to investors, and the subordinated portion that is retained by the originator as initial trustor. Trusts can be formed flexibly under the Trust Act of Japan pursuant to the terms and conditions of trust agreements. In some cases, investors make an investment by way of loans to the trustee, in which case, the trustee will redeem the senior portion of the TBIs to repay loans with cash inflow from the entrusted assets. The trust structure is adopted for securitisation of both real estate properties and receivables. As a general rule for corporate income taxation, a trust itself is not subject to taxation. The concept of 'self-trust' was introduced in 2006 with the amendment to the Trust Act, and subsequently gained popularity as a means for originators to securitise their assets by way of self-declaration of trust, particularly for securitisation of receivables with no-assignment clauses.

The real estate investment trust (REIT) is another type of securitisation vehicle. The J-REIT, introduced with the amendment to the Act on Investment Trusts and Investment Corporations in Japan in 2000, is a legal entity used mainly for holding real estate properties and for financing by way of loans and issuance of investment units. There are two types of REIT in Japan: public REITs, which are listed on the stock exchange, and private REITs. In general, the term 'J-REIT' typically refers to those listed on the stock exchange. In contrast to the GK-TK and TMK structures, which can be adopted for developing new real estate properties, the J-REIT is mainly utilised for the securitisation of existing real estate properties that generate a cash flow from leases.

## II REGULATION

### i Regulatory regime

#### *GK-TK structure*

##### *Financial Instruments and Exchange Act*

The Financial Instruments and Exchange Act of Japan (FIEA) contains the main securities regulatory framework in Japan. In 2007, the FIEA was amended to broaden the definitions of securities and financial instrument business, as a result of which securitisation became subject to stricter regulations.

Under the FIEA, TBIs and TK investments are deemed regulated securities (Type II securities), and licensing is required to engage in solicitation, purchase, sale and brokering of regulated securities. Accordingly, a GK has to retain an operator registered to conduct Type II finance instruments business to solicit TK investors to provide TK investments. In addition, a GK's business of investment in TBIs with the funds obtained through TK investments

requires registration as an investment management business operator under the FIEA. Certain exemptions, however, are available for GKs to avoid these registration requirements. One exemption is the 'Article 63 business exemption', which requires a GK simply to file a notification with the relevant local finance bureau if its TK investors consist of the following:

- a* at least one qualified institutional investor (QII); and
- b* 49 or fewer non-QIIs who satisfy certain requirements (including legal entities registered as business operators under the FIEA, listed companies, joint-stock corporations under the Companies Act of Japan with stated capital exceeding ¥50 million, foreign companies and certain high-net-worth individuals). Under other exemptions, the GK will not be required to register as an investment management business operator if it delegates its entire investment authority to a registered investment manager under a discretionary investment management contract.

### *RESJEA*

A business operator who holds real properties and accepts investments through certain legal arrangements (including through a TK) is required to obtain governmental approval under the RESJEA. However, since it is impractical for an SPV to obtain such approval, GKs typically hold the property in the form of a TBI.

Certain exemptions to the licensing requirements were introduced by the amendments to the RESJEA in 2013 and 2017, subject to fulfilment of certain conditions, including:

- a* delegation of all asset management activities to a licensed asset manager; and
- b* all investors involved being qualified special investors.

### ***TMK structure***

#### *Securitisation Act and supervision by the FSA*

As briefly explained in Section I, a TMK is regulated under the Securitisation Act. Under the Securitisation Act, a TMK is required to file a business commencement notice and an ALP setting out an overview of the TMK's business, including its securitised assets and the terms and conditions of the asset-backed securities or asset-backed loans to be issued or borrowed by the TMK. There are certain restrictions on amendments to an ALP and, in most cases, material changes to an ALP will require the unanimous consent of the interested parties. A TMK's business is restricted to the scope set out in an ALP. In particular, it should be noted that securitised assets are required to be specified from the outset in an ALP and there is some restriction on the TMK obtaining additional assets, especially real estate properties.

A TMK is not subject to the RESJEA. However, if the securitised assets are acquired and held in the form of fee simple properties, the asset manager must meet certain financial and organisational requirements, including the requirement to obtain governmental approval under the RESJEA.

Furthermore, a TMK is subject to supervision by the FSA. The FSA's authority extends to site investigations and various administrative orders. In addition, a TMK is required to file certain periodical reports with the relevant local finance bureau in respect of its business.

### *FIEA*

Under the FIEA, specified bonds and preferred shares issued by a TMK are deemed regulated securities (Type I securities) and a certain licence is required for handling solicitation, purchase, sale and brokering of regulated securities. Accordingly, a TMK has to retain an

operator registered to conduct Type I finance instruments business to solicit both subscribers for specified bonds and investors for TK investments. In addition, if a TMK delegates its TBI asset management, the asset manager must be qualified as a registered investment manager or registered investment adviser.

### ***Trust structure***

#### ***Trust Act***

In principle, TBIs are created pursuant to a trust agreement between trustors and a trustee under the Trust Act of Japan. Trustees engaged in the trust's business will be subject to various regulations, including licensing requirements and fiduciary requirements under the Trust Act of Japan.

#### ***FIEA***

As noted above, TBIs are regarded as regulated securities (namely Type II securities) and licensing is required for handling solicitation, purchase, sale and brokering of regulated securities.

## **ii Tax issues**

### ***Stamp tax***

Stamp tax is levied by the national government on certain documents, including various contracts. For instance, a contract for the sale and purchase of real estate properties will be subject to a stamp tax of up to ¥480,000, depending on the purchase price. Moreover, a contract for assignment of TBIs and receivables will be subject to a stamp tax of ¥200.

### ***Registration and licence tax***

Registration and licence tax is levied on registrations of transfers or creation of mortgages over real estate properties, receivables or TBIs. The rate of the registration tax varies depending on the type of the transaction and the value of the relevant assets or secured claims. For instance, the tax rate for registration of transfer of a nonresidential building is 2 per cent of the property value, which will be reduced to 1.3 per cent if the transferee is a TMK. By contrast, creation of a trust on a non-residential building is subject to taxation of 0.4 per cent of the property value. The tax rate for registration of transfer of a TBI (change of trust beneficiary) is ¥1,000 for each trust property.

### ***Real estate acquisition tax***

A real estate acquisition tax is levied on the acquisition of land or buildings at the tax rate of 3 per cent (for land and residential buildings) or 4 per cent (for non-residential buildings) of the tax base of the subject property. A TMK is entitled to the benefit of a reduction in the tax base to 40 per cent of the subject property. However, acquisitions of TBIs and receivables are free from acquisition tax.

### **Corporate tax**

If an SPV that is utilised for a securitisation transaction is treated as a taxable entity, it will recognise taxable income and will be subject to corporate income tax. This may cause double taxation, with income taxation on both the profits of the SPV and the profits distributed to investors, which would result in a decrease in investment returns. Investors can avoid such double taxation by adopting a tax-efficient structure.

Under a GK-TK structure, the taxable income of a GK will be subject to corporate tax. However, the profits distributed to TK investors are recorded as a deductible expense at the level of the GK, as an operator of the TK partnership, and investors can thus avoid double taxation.

Similarly, under the TMK structure, although a TMK is a taxable entity and subject to corporate tax, the profits distributed to preferred shareholders are recorded as a deductible expense at the level of the TMK if certain tax-conduit requirements under the Act on Special Measures Concerning Taxation are met. The tax-conduit requirements include:

- a* all specified bonds, specified loans and preferred shares are provided (or are expected to be subscribed for) by certain qualified institutional investors, among others;
- b* more than 50 per cent of the TMK's preferred shares (and certain common shares) are planned to be offered in Japan under the ALP;
- c* the TMK's accounting period does not exceed one year; and
- d* more than 90 per cent of the distributable amount is distributed as dividends.

Under the trust structure, the trust itself will not be regarded as a taxable entity. However, the beneficiaries owning the TBIs will be treated as possessing the trust properties for tax purposes.

## **III SECURITY AND GUARANTEES**

### **i Security in loan transactions**

For security transactions in which acquisition funds are raised by way of loans, the assets of SPVs are usually provided as collateral for securing the loan obligations of the SPVs. The form of security and method of perfection vary depending on the type of the subject assets.

#### ***Real estate***

The most common form of security interest over real estates is the mortgage. A mortgage is perfected by registration in the relevant property registry.

#### ***Receivables***

The principal forms of security interest over receivables (e.g., bank account receivables, trade receivables and loan receivables) are (1) pledges; and (2) collateral assignments. Both pledges over, or collateral assignments of, receivables are perfected against the debtor of the receivables by giving notice to, or obtaining consent from, the debtor. By using an instrument bearing a certified date of the notice or consent, the security interests will be perfected against third parties other than the relevant debtor. In addition, the creation of pledge and collateral assignments can also be perfected against third parties other than the relevant debtors by registration at the loan assignment registry if the assignor of the claims is a corporation.

### ***TBIs***

The most common form of security interests over TBIs is the pledge. A pledge over TBIs is perfected against the relevant trustee by giving notice to, or obtaining the consent from, the relevant trustee. As is the case with a pledge for receivables, perfection against third parties other than the trustee can be achieved by using an instrument bearing a certified date of the notice or consent.

### ***Equity interest in SPVs***

Equity interests in an SPV (e.g., membership interests in a GK or specified shares in a TMK) will be subject to security interests in the form of a pledge. The methods for perfection of a pledge over equity interests depend on the type of membership interest involved (namely procurement of consent from the SPV and other members, registration in the shareholders' register or delivery of share certificates).

#### **ii Security in bond transactions**

In respect of security transactions in which the acquisition funds are raised by way of bonds without any loan element, under the Secured Bond Trust Act of Japan, certain cumbersome restrictions (including the retention of a security trustee) will apply in the creation of security interests over specific assets to secure the bond.

However, in a TMK structure where a TMK raises funds by issuing specified bonds, the specified bonds will be secured by a general lien under the Securitisation Act. A general lien is a kind of statutory lien granted over all the properties belonging to the TMK by virtue of law. A general lien is registrable in the corporate register of the TMK, but generally does not require performance of any perfection procedures for assertion of the general lien against third parties.

## **IV PRIORITY OF PAYMENTS AND WATERFALLS**

### **i Cash management**

One of the key aspects of securitisation transactions in Japan is the strict control over usage of an SPV's cash flow imposed by covenants in the relevant financing documents. Typically, all the cash belonging to the SPV will be managed in the bank account of the financing banks. In addition, the order of priority in a cash waterfall is predetermined to prevent the leakage of cash from the SPV. The typical order of priority in a cash waterfall is as follows:

- a* payment of costs required for the purpose of maintaining the transaction scheme (e.g., trust fees) and management of the SPV;
- b* establishment of scheduled cash reserves for the purpose of meeting future cash outlays (such as CAPEX);
- c* payments of the principal and interest amounts under debt obligations; and
- d* distribution of excess cash to equity investors as dividends.

## **ii Subordination**

In Japanese securitisation transactions, equity investors' monetary claims against SPVs are subject to contractual subordination arrangements that typically involve:

- a* restriction of distribution of excess cash to equity investors upon the occurrence of certain trigger events, including non-satisfaction of certain criteria that measure the financial index of the SPV's cash flow and value of the securitised assets (which are curable upon discontinuation of the trigger event);
- b* suspension of all the monetary obligations of the SPVs to equity investors upon the commencement of any insolvency proceedings or default of senior debt obligations until all the senior claims have been fully repaid; and
- c* in the case of insolvency, characterising the monetary claims of equity investors against SPVs as consensually subordinated insolvency claims that are subordinate to other insolvency claims by virtue of insolvency law.

## **V ISOLATION OF ASSETS AND BANKRUPTCY REMOTENESS**

### **i Bankruptcy remoteness**

In Japan, the concept of bankruptcy remoteness is generally understood to mean that (1) securitised assets will not be affected by the originator's bankruptcy or insolvency proceedings; and (2) the SPV itself will not be subject to bankruptcy or insolvency proceedings.

### **ii Isolation of assets – true sale**

To achieve the isolation of assets from bankruptcy proceedings in respect of the seller (that is, the originator), it is important to ensure that the asset transfer constitutes a true sale.

The concept of 'true sale' under Japanese law generally requires that (1) the transfer of assets by the originator is not regarded as provision of collateral; and thus (2) the transferred assets no longer belong to the originator's insolvency estate. No statutes clearly stipulate the explicit conditions under which a transfer of assets will be regarded as a true sale. Rather the existence (or otherwise) of true sale is generally understood to be determined by careful consideration of several elements, including:

- a* the intentions of the transferor and transferee;
- b* whether the asset transfer has been perfected;
- c* the reasonableness of the transfer price;
- d* whether the transferor has the right or obligation to repurchase the asset;
- e* whether the asset is recorded on the balance sheet of the transferor; and
- f* whether the rights of control remain with the transferor.

In respect of item (f) above, the following measures will typically be taken to isolate the SPV and the securitised asset from the right of control of the originator as transferor:

- a* causing the SPV's common shares to be held by another SPV that is independent from the originator. The independent SPV typically takes the form of a general incorporated association under the General Incorporated Association and General Foundation Law of Japan (or a Cayman charitable trust); and
- b* appointing independent directors (who are often public certified accountants or judicial scriveners) to the SPV and its common shareholders.



### **iii Minimising risk of an SPV's bankruptcy**

The principal way of minimising the risk of an SPV's bankruptcy or insolvency is the imposition of contractual restrictions on the SPVs' capacity to engage in any activities related to the acquisition, management and disposition of the securitised assets. SPVs are also prohibited from amending their constitutional documents without the approval of the financing parties. In addition, the cash flow of SPVs is strictly controlled by an agreed cash waterfall (see Section IV.ii).

Moreover, the parties in contractual relationships with SPVs are also subject to certain contractual arrangements, such as limited recourse clauses (which obligate the parties to waive any of their monetary claims against the SPV that remain unpaid after the disposition of all the SPV's assets) and non-petition clauses (which prohibit the parties from making a petition for commencement of bankruptcy and insolvency proceedings against the SPV). It is uncertain whether Japanese courts will uphold the validity of non-petition clauses when a petition for insolvency proceedings is actually made in violation of such a clause.

It is also important to isolate the SPV from the originator's control by the measures set out in (a) and (b) in Section V.ii to prevent any insolvency proceedings from being commenced by the SPV's directors at the originator's discretion.

## **VI OUTLOOK**

The Amendments to the Civil Code of Japan came into force on 1 April 2020. The Amendments cover a broad range of items, including statutes of limitation, guaranties, contracts and assignments of claims. While many of the provisions were revised based on existing court precedents and other legal theories generally accepted in Japan, the Amendment also introduced some new rules. One of the features affecting securitisation transactions relates to assignments of non-assignable receivables, namely receivables that are contractually prohibited or restricted from assignment. Under the former legislation, assignment of such non-assignable receivables would have been deemed null and void. Self-trust was adopted as a securitisation scheme for the non-assignable clause on the basis that a self-trust by a creditor of receivables does not constitute an assignment because the receivables are not transferred to parties other than the creditor. By contrast, under the amended Civil Code, an assignment of non-assignable receivables is deemed valid in principle. The new regime under the amended Civil Code provides more options for the securitisation of non-assignable receivables. However, an assignment of non-receivables can still be deemed a breach of contractual restrictions, which can result in the cancellation of the contracts underlying the receivables.

Pre-covid-19 pandemic, the Japanese securitisation market had shown stable growth and signs of expansion. In terms of real estate, Japan had seen increasing demand for inbound investments into accommodation facilities (especially in the Greater Tokyo Area) until the occurrence of the covid-19 pandemic. However, as noted above, the covid-19 pandemic may enhance the decentralisation of the industry and close attention has to be paid to how the market will develop. Nevertheless, continuing demand for logistics properties amid the pandemic is expected, driven by the growth in e-commerce services. Healthcare facilities are also anticipated to expand in light of the demographic trends in Japan. In addition, data centre facilities are attracting more attention from both investors and debt finance providers.

## ABOUT THE AUTHORS

### **KAZUNARI ONISHI**

*Anderson Mōri & Tomotsune*

Kazunari Onishi advises on a wide variety of international and domestic finance transactions. He focuses primarily on structured finance and real estate transactions. He regularly advises global financial institutions, including funds, major investment banks and asset management companies with active operations in Japan.

### **HIKARU NAGANUMA**

*Anderson Mōri & Tomotsune*

Hikaru Naganuma is a partner at Anderson Mōri & Tomotsune. He handles an extensive range of corporate matters, with an emphasis on securitisation of real properties and receivables, project finance, syndicated loans, real estate transactions and M&A transactions. He has assisted both domestic and overseas clients in a variety of cross-border transactions in the areas of real estate investment, banking and corporate acquisitions.

### **SAORI KAKISHITA**

*Anderson Mōri & Tomotsune*

Saori Kakishita is an associate at Anderson Mōri & Tomotsune, where she works in the finance sector. She has also assisted in multiple finance transactions, including syndicated loans and real estate transactions.

### **ANDERSON MŌRI & TOMOTSUNE**

Otemachi Park Building

1-1-1 Otemachi

Chiyoda-ku

Tokyo 100-8136

Japan

Tel: +81 3 6775 1000

kazunari.onishi@amt-law.com

hikaru.naganuma@amt-law.com

saori.kakishita@amt-law.com

www.amt-law.com/en

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