

Latest amendments to the TMK Law and their impact

Introduction

The Act to Amend Part of the Financial Instruments and Exchange Act, etc. for the Strong Foundation of Capital Markets and Financial Business was enacted on 17 May 2011 and promulgated on 25 May 2011. This amendment Act includes amendments to several laws such as the Financial Instruments and Exchange Act, but this Briefing focuses on amendments to the Act on Securitisation of Assets¹ (often called the "TMK Law", the Securitisation Law) that came into force on 24 November 2011. Along with the amendments, the related cabinet order and cabinet office ordinance were amended (the cabinet office ordinance as amended, the Amended Cabinet Office Ordinance) which came into force on 24 November 2011.

This Briefing mainly explains two of the practical impacts of the amended Securitisation Law: (i) amendments concerning acquisition of specified assets; and (ii) amendments concerning the means of financing.

Amendments concerning Acquisition of Specified Assets

(1) Possibility of Additional Acquisition of Specified Assets

The Securitisation Law uses the concept of specified assets². These are the assets specified in the asset liquidation plan (the ALP)³ for special purpose companies under the Securitisation Law (*tokutei mokuteki kaisha*, or TMKs) as being the assets to be acquired by the TMK. Under the old Securitisation Law, as there was no provision concerning additional acquisition of specified assets, it was not clear whether it was possible for a TMK to acquire additional specified assets by revising its ALP.

Key issues

Introduction

Amendments concerning Acquisition of Specified Assets

Amendments concerning Means of Financing

Other Major Amendments

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¹ *shisan no ryudouka ni kansuru horitsu*

² *tokutei shisan*

³ The ALP is a plan that has to be drawn up when a TMK is established and has to detail matters such as the specified assets to be acquired, the debt that will be incurred to finance the acquisitions, and many other aspects relating to the proposed operations of the TMK. In practice, if the TMK wanted to acquire additional assets, the general view is that only new assets having a certain connection with the existing specified assets were permitted.

The amended Securitisation Law, on the other hand, stipulates⁴ that any revision of the ALP for acquisition of additional specified assets requires submission of the purchase agreement of those specified assets to the relevant Local Finance Bureau⁵. This amendment is helpful since it clarifies that the acquisition of additional specified assets is possible. However, according to the summary of comments and the view of the Financial Services Agency towards such comments published on 11 November 2011 (the FSA's View), the FSA's View is (i) although it is generally possible, after revising the ALP, to acquire additional specified assets that have no connection with the existing assets, (ii) if the new specified assets are a "building lot" or a "building" defined under the Building Lots and Buildings Transaction Business Act, they will not be permitted unless there is a close connection with the existing specified assets⁶.

Accordingly, where a TMK acquires assets other than real property as specified assets, the TMK structure is allowed to be used flexibly by acquiring additional specified assets by revising its ALP, however, where the specified assets consist of buildings or building lots, the TMK is still restricted in what additional real property it can acquire.

(2) Establishment of the Concept of Associated Specific Assets

Under the old Securitisation Law⁷, where a TMK acquired movable assets associated with real property, the TMK was not allowed to appoint an asset manager to manage those assets, and as a result, this prevented securitisation of real property with significant movables (hotels and nursing homes, for example).

This has been addressed under the amended Securitisation Law⁸, and a TMK is now allowed to appoint an asset manager to manage movable assets as **associated specified assets** in circumstances where: (i) the movable assets are used integrally with its real property assets (including real property trust beneficiary interests) and (ii) they contribute to securing revenues of the securitisation business conducted with respect to that real property .

According to the FSA's View⁹, in order to determine whether movables qualify as associated specified assets, a two-fold test applies: first, an economic master-servant relationship must exist between the moveables and the existing specified assets, and secondly, the total value of the associated specified assets must not exceed the total value of the specified assets. Helpfully the FSA's View contains a statement¹⁰ that the associated specified assets are not required to be physically a unit of the principal specified assets and it is sufficient that they are functionally one unit, and, in addition¹¹, that the owners of the principal specified assets and the associated specified assets need not be the same (which covers situations where, for example, technically title to a building is held by a trustee but the moveables are owned by the TMK).

⁴ Article 29, Paragraph 3 of the Amended Cabinet Ordinance

⁵ *zaimu kyoku*

⁶ No. 36 to No. 44 of the FSA's View

⁷ Article 300, Paragraph 3 of the old Securitisation Law

⁸ Article 200, Paragraph 2, Item 5 and Article 4, Paragraph 3, Item 3 of the Amendment Law and Article 6-2 of the Amended Cabinet Office Ordinance

⁹ Through No. 3 to 4 of the FSA's View

¹⁰ No. 8 of the FSA's View

¹¹ No. 10 of the FSA's View

So, for example, movable assets such as hotel equipment are now considered to be associated specified assets and this will allow TMKs greater flexibility in the types of businesses they can acquire.

Associated specified assets are not required to be described as specified assets in a TMK's ALP and neither is the assignment agreement for those assets required to be submitted to the Local Finance Bureau.

(3) Abolition of Duty of Notification by Seller of Specified Assets and Trustee

The old Securitisation Law¹² imposed a requirement that agreements entered into by TMKs to purchase specified assets contain an obligation on sellers to notify the TMK of certain matters that have to be described in a registration statement if the TMK needed to file a registration statement (i.e. if it were to make a public offer of securities). This caused some confusion, particularly since it was not clear exactly what had to be notified, and made it difficult for TMKs to conduct purchases from sellers who were not used to transactions with TMKs. The amended Securitisation Law abolished this requirement.

Similarly, the equivalent notification requirements imposed on trustees to the TMK¹³ and on asset managers of the TMK¹⁴ were also abolished. This is helpful since, before the amendment, whenever a TMK acquired trust beneficiary interests the TMK and the trustee had to enter into an amendment agreement to the trust agreement to include this notification obligation on the trustee.

Amendments concerning Means of Financing

(1) Abolition of Restriction of Use of Proceeds in a Specified Purpose Loan

Under the old Securitisation Law, it was not clear whether specified purpose loans (*tokutei mokuteki kariire*) could be used to refinance existing debt incurred for the acquisition of specified assets, since the relevant provision¹⁵ of the old Securitisation Law merely provided that TMKs were able to borrow specified purpose loans (i.e. loans for purchasing the specified assets) for funds necessary for acquisition of specified assets. Under the amended Securitisation Law¹⁶, the term specified purpose loan is amended to specified loan and the restriction of use for the acquisition of specified assets is abolished. This has clarified the position regarding refinancing loans.

(2) Relaxation of Requirements for Other Loans

Under the old Securitisation Law, while TMKs were able to borrow what are known as "other loans"¹⁷ (Other Loans) under certain conditions (for example that the lenders be qualified institutional investors and other requirements as provided in the Cabinet Office Ordinance). Therefore, in the case where the TMK had a temporary liquidity shortfall, it had no choice but to look for a lender who was a qualified institutional investor for short-term financing or to look for additional equity investment.

¹² Article 199

¹³ Article 200, Paragraph 2, Item 1 of the old Securitisation Law

¹⁴ Article 200, Paragraph 4, Item 4 of the old Securitisation Law

¹⁵ Article 210 of the old Securitisation Law

¹⁶ Article 201 of the amended Securitisation Law

¹⁷ Latter Part of Article 211 of the old Securitisation Law

The amended Securitisation Law¹⁸ has abolished the restriction of only being able to use qualified institutional investors for Other Loans and allows TMKs to borrow Other Loans from any person, which includes its sponsors. In addition, in the case of refinancing loans, the requirements provided in the Amended Cabinet Office Ordinance (for example, to include a summary of the loan in the ALP) need not be fulfilled if the period of the loan has a maturity of one year or less. This provides welcome flexibility.

Other Major Amendments

Other than the above, major points of the amendments include the following:

- the obligation to notify slight and partial revisions of the ALP is abolished¹⁹
- in the case of acquisition of real estate (including real estate trust beneficiary interests) as specified assets, the two-phase procedure that comprised the appraisal and price survey is unified into one appraisal²⁰
- it is possible to apply revenues from the management or disposal of specified assets to acquisition of specified assets if that is prescribed in the ALP²¹.

It is thought that these amendments are intended to promote securitisation using the TMK structure, particularly development projects, through relaxation of previous regulations. This is in line with earlier amendments to the Securitisation Law, which have gradually relaxed the regime over the years since its introduction.

In addition to the above amendments, the amended Securitisation Law contains provisions designed to enable issuance of Islamic bonds in Japan. For more information, please refer to our recent Client Briefing entitled "Islamic Finance – Japanese Law Reforms" (Winter 2011)²².

Where Japanese legal concepts have been expressed in the English language, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.

¹⁸ Article 94, Subparagraph 2 of the Amended Cabinet Office Ordinance

¹⁹ Article 9 of the amended Securitisation Law and Article 26-2 of the Amended Cabinet Office Ordinance

²⁰ Article 40, Paragraph 1, Item 8 of the amended Securitisation Law

²¹ Article 14, Paragraph 4 of the Amended Cabinet Office Ordinance

²² **Islamic Finance - Japanese Law Reforms** (Winter 2011)

http://www.cliffordchance.com/publicationviews/publications/2011/12/islamic_finance_-_japaneselawreforms.html

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