
Revisions To The SPC Law and Developments in Securitization

Yuta Seki

On 23 May 2000 the lower house of the Diet approved proposed revisions to the SPC Law governing asset securitization. The bill is scheduled to become law within 6 months after 31 May when the law was promulgated. This report will outline the main revisions contained in the bill, analyze the impact it is likely to have and consider the outlook for the future of the rapidly growing ABS (Asset Backed Securities) market in Japan.

1. The SPC Law And Its Effect

Many in Japan had long wanted the government to set up a legal infrastructure to enable companies to set up separate “conduits”¹ able to securitize a wide variety of asset types. Sparked off by the bad-debt crisis that erupted around Japan’s specialist mortgage providers (*jusen*), calls for comprehensive measures to increase the liquidity of debts and real-estate collateral intensified. This was coupled with calls for a legal system to create a market in asset-backed securities (ABS) as part of the “Big-Bang” program of financial sector deregulation. These two factors brought the debate over an SPC law to fever pitch by the second half of 1997.

After the Ministry of Finance’s SPC discussion group, set up in September 1997, had debated and announced its interim findings regarding SPC legislation, the SPC Law (full title “Law Concerning Securitization of Specified Assets by Special Purpose Companies”) was put before both houses of the Diet in March 1998, approved in June and came into force in September that year.²

1) Securitization Under The SPC Law

Between September 1998 when the SPC law came into force and end March 2000 the total number of SPCs registered with the Kanto Financial Bureau of the Ministry of Finance reached 37, 17 of which issued securities covering assets in the form of real-estate or real

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- 1 A body that is able to issue securitized products without being subject to double taxation (corporation tax on profits at the company level, plus income tax on dividends paid out at the investor level), and a vehicle into which assets can be transferred in order to securitize them. If established in company form it is generally called a “Special Purpose Company” (SPC).
 - 2 For an examination of the debate surrounding the introduction of the SPC Law please refer to M. Hashimoto “The Recent Developments in Securitization in Japan,” (Capital Research Journal, summer 1998).

estate trust beneficiary certificates. The total upper issue limits of these SPCs (including bonds and senior investment securities) according to their respective securitization plans has reached a total of about ¥2.15 trillion.

In terms of asset types, 9 SPCs hold lease receivables for a total issue limit of ¥520 billion, which is a similar high share as with securitized assets under the Specified Claims Law. However since the end of 1999 the number of SPCs holding real estate and real-estate trust certificates as assets has been steadily increasing, and now the total issue limit on real-estate type SPCs is around ¥590 billion. The types of real-estate being securitized tend to be mainly office buildings, rental apartments, bank branch offices and retail shops.

Table 1 SPCs Registered With The Kanto Financial Bureau (as at March 2000)

| | Name | Date registered | Originator | Assets | Issue limit | Scheme duration |
|----|---------------------------------|------------------------|---------------------------------|---------------------------------|--------------------|------------------------|
| 1 | Takanawa Apartments | Nov-98 | Morimura Sangyo, Forest Village | Rental apartments | ¥11 billion | 7 years |
| 2 | Someino S C | Jan-99 | Tokyu Land | Shopping centre | ¥9 billion | 10 years |
| 3 | Majesty Asset Funding | Jan-99 | NTT Leasing | Lease payment receivables | ¥50 billion | 7 years |
| 4 | Orico Shop | Jan-99 | Orient Corporation | Installment payment receivables | ¥70 billion | 7 years |
| 5 | Century Asset Funding | Feb-99 | Century Leasing Systems | Lease payment receivables | ¥20 billion | 7 years |
| 6 | Network Capital | Mar-99 | Sumitomo Bank | Bank branch offices | ¥44 billion | 5 years & 6 months |
| 7 | Orico Shop Series 2 | May-99 | Orient Corporation | Shopping credit receivables | ¥60 billion | 6 years |
| 8 | KC Prime Asset Funding | Jun-99 | Kokunai Shinpan Co. | Auto-loan receivables | ¥100 billion | 10 years |
| 9 | Sunflower Funding | Jun-99 | Showa Leasing | Lease payment receivables | ¥150 billion | 20 years |
| 10 | Pacific Century Residential One | Jun-99 | City Light Development etc. | Rental apartments | ¥16 billion | 15 years |
| 11 | SCL Enterprises | Jun-99 | Sumisho Leasing | Lease payment receivables | ¥50 billion | 8 years |
| 12 | Oracle Alpha | Jun-99 | Orient Corporation | Auto-loan receivables | ¥50 billion | 7 years |
| 13 | Kyoudo Jutaku Shoukenka | Jun-99 | Starts Corp. | Rental apartments | ¥300 million | 7 years |
| 14 | MCL Japan Funding | Aug-99 | Mitsubishi Auto Credit | Automobile credit receivables | ¥30 billion | 6 years |
| 15 | Orico Shop Version 3 | Sept-99 | Orient Corporation | Installment payment receivables | ¥60 billion | 6 years |
| 16 | SMAC | Sept-99 | N/A | Specified money claims | ¥500 billion | 20 years |
| 17 | Star Capital | Sept-99 | Nippon Life | Rental office buildings | ¥50 billion | 50 years |
| 18 | Tropical Holdings | Sept-99 | Japan Buildings Project | Rental office buildings | ¥14 billion | 11 years |
| 19 | STBL Funding | Nov-99 | Sumishin Leasing | Lease receivables | ¥100 billion | 20 years |
| 20 | SCL International | Nov-99 | Sumisho Leasing | Lease payment receivables | ¥40 billion | 8 years |
| 21 | TA Funding | Dec-99 | Toshiba Credit | Lease payment receivables | ¥50 billion | 10 years |
| 22 | Omori Seashore Development | Dec-99 | Asahi Buildings | Factory site | ¥40 billion | 12 years |
| 23 | Neopasu Kawasaki | Dec-99 | Nittochi Buildings | Rental office buildings | ¥3.6 billion | 12 years 6 months |
| 24 | Nakabayashi | Dec-99 | Kojin | Land and buildings | ¥35 million | 4 years 6 months |
| 25 | Oracle Beta | Jan-00 | Orient Corporation | Auto-loan receivables | ¥50 billion | 7 years |

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|----|-----------------------|--------|-------------------------------|--|-------------|-------------------|
| 26 | BOTL Asset Funding | Jan-00 | Bank of Tokyo Leasing | Lease payment receivables | ¥30 billion | 8 years |
| 27 | FLA Asset Funding | Jan-00 | Fujitsu Leasing | Lease payment receivables | ¥30 billion | 20 years |
| 28 | ACS Card Funding | Jan-00 | Aeon Credit | Credit card receivables | ¥15 billion | 8 years |
| 29 | Forester | Feb-00 | Jasco, and others | Buildings | ¥84 billion | 31 years 6 months |
| 30 | Millenium Capital | Feb-00 | Daiichi Life | Land and buildings | ¥50 billion | 7 years |
| 31 | Millenium Residential | Feb-00 | Mitsui Fudosan | Apartment lots | ¥30 billion | 5 years |
| 32 | Orico Shop Ariesu | Feb-00 | Oriental Corporation | Specified money claims | ¥60 billion | 6 years |
| 33 | Fund One | Feb-00 | Mitsui Fudosan, Sumitomo Life | Land & buildings | ¥90 billion | 20 years |
| 34 | Orchid Properties | Feb-00 | Orchid Properties | Land & buildings | ¥45 billion | 10 years |
| 35 | Fuso Funding | Mar-00 | Bank of Tokyo Leasing | Automobile payment installment receivables | ¥50 billion | 7 years |
| 36 | Urbanity Capital | Mar-00 | Nippon Life | Rental office buildings | ¥50 billion | 8 years |
| 37 | Red Lions Capital | Mar-00 | Yasuda Life | Land & buildings | ¥55 billion | 20 years |

Source: Organization for Promoting Urban Development “Real Estate Securitization” (May 2000)

2) SPC Law Paves The Way For The CMBS Market

The SPC law opened a new chapter in the Japanese ABS market, opening the way for new asset types to be securitized and form the basis of cash flows. Traditionally the Japanese ABS issues were dominated by lease and credit receivable. From the standpoint of real-estate securitization, the SPC law was a turning point as it established CMBS (Commercial Mortgage-backed Securities) market in Japan. This made it possible for businesses to use their real estate holdings under a sale and leaseback arrangement as a flexible method of procuring funds at a time when credit ratings across Japanese industry were generally deteriorating, or in cases where a large amount of capital investment needed to be made.³

So far the securitization schemes undertaken in Japan under the SPC law have generally been of relatively healthy assets held by corporates and life insurance companies, despite the fact that perhaps the single most important contributory factor to the passing of the SPC law was the political will to open the way to disposal or securitization of real estate collateral on problem loans. While often it has been the case that these securitization projects have fulfilled urgent funding requirements, they have not been used to make any final disposal of the problem loans held by Japan’s banks and non-banks as was originally envisaged by Japan’s politicians.

3 Sale and leaseback (simultaneous sale of an asset to an SPC to remove it from the balance sheet and entry into a lease arrangement with the SPC for continued use of the asset) arrangements have become a popular financing tool in the US. In Japan in some cases however, due to a lack of investors interested in purchasing subordinated debt or senior investment securities, the originator has to sometimes carry on holding the asset (though there are also cases where the originator prefers not to completely sell the asset), and therefore this is sometimes not recognized as a “true sale.”

Industry observers have pointed to a number of failings of the current SPC legislation. In the main their criticisms centre on 3 issues: the lack of flexibility in issuing securities owing to the requirements on registration of securitization plans; the long time taken to approve registrations; the capital requirement for establishing an SPC. By way of example, the current law requires that any changes to a securitization plan must receive the prior approval of the Financial Reconstruction Commission unless the changes are clearly both minor and do not impinge on general investor protection. Further, current legislation stipulates that in addition to the securitization plan, in order for an SPC to be registered an asset securitization implementation plan (under Article 6 of the current SPC law) must be submitted, and at the discretion of the Prime Minister's office and Ministry of Finance a draft contract for the assignment of specified assets and management consignment contract that together detail how the securitization process will in fact be carried out may also be required.

A further problem being highlighted is the issue of bankruptcy remoteness. SPCs incorporated in Japan are not able to use an equivalent to the charitable trust structure that is common in the US and UK, and consequently investors in SPC issued bonds cannot be insulated from the risk of the originator going bankrupt. This then affects the credit rating of the debt being issued by the SPC, and makes incorporation of SPCs overseas a more attractive option.

Finally, one problem affecting real estate securitization is the heavy tax payable on assignment of real estate assets to an SPC. On assignment of real estate assets to an SPC, the current real estate tax system levies a 4.5% charge on the value of the real estate assigned in the form of a registration and licensing tax and a real estate acquisition tax. In addition to which the assignor must pay tax on any profits realized on the assignment. The current SPC law revisions have not however tackled reform of the tax system as regards real estate acquisition.

2. Revisions to the SPC Law ~ Outline of the “Asset Securitization Law”

The Financial System Council (an advisory panel to Japan's Minister of Finance) set up a “Collective Investment Schemes Working Group” under its first sub-committee whose 10-month examination resulted in a second interim report published on 21 December 1999. This report set forth government policy on both reform of the SPC Law and the Investment Trust Law,⁴ and was a major influence on the current SPC law revisions.

The bill for revisions to the SPC Law was approved by the cabinet on 17 March 2000 along with revisions to the Investment Trust Law, and both sets of reforms then passed into law on 23 May. Below we will outline the significant points contained therein.

4 For an explanation of Japan's collective investment schemes and the contents of the Financial System Council's second interim report, readers should refer to Y. Seki “Japan Debates the Introduction of Real Estate Investment Trusts” (Capital Research Journal, Spring 2000). Concerning revisions to the Investment Trust Law please refer to Y. Seki “Investment Trust Law Revisions To Expand Scope Of Investments” (Capital Research Journal, Summer 2000).

1) Aim of The Revised SPC Law – Legislative Foundation For Asset Securitization

With the SPC Law revisions the purpose of the SPC Law has shifted from emergency legislation to deal with a particular financial crisis prevailing at a particular point in time to the more general and long-term aim of a “legislative foundation for asset securitization.” The name of the law will also therefore change to the “Law Concerning Securitization of Assets.”⁵ The first clause sets out the purpose of the revised law as “the establishment of a legal framework to enable the securitization of assets via a special purpose company or special purpose trust, to ensure that the securitization of such assets by such means can be carried out in an appropriate manner, and by promoting the protection of purchasers of the various security types issued as part of the asset securitization process, to facilitate investment by ordinary investors in asset-backed securities.”

“Asset securitization” is further defined as “the purchase of assets by a special purpose company funded either by the issuance of securities against those assets or by a special purpose loan, or the issuance of beneficiary securities backed by assets held in trust by an investment trust company or bank or other financial institution conducting investment trust business, with the money obtained through the management or disposal of these assets being used to make payments on loans or corporate bonds, or dividends on senior investment securities” (Article 2-2 of the revised law).

The permitted investment targets for SPCs, previously limited to real estate, specified money claims, and trust beneficiary certificates on real estate and specified money claims held in trust, will under the revised legislation be expanded to cover a wider range of general claims on asset. Article 2-1 of the revised law defines specified assets as “assets purchased by special purpose companies or trust companies for the purpose of securitization.”

There will still however be some restrictions on the assets SPCs may purchase, which are to include equity interests in voluntary partnership contracts under the Civil Code, equity interests in anonymous partnership contracts under the Commercial Code, and other instruments as specified by government ordinance (Article 151-1).

2) Streamlined Procedure For Establishment Of SPCs

The revised law changes the current registration system (with the Financial Reconstruction Commission) for setting up SPCs to a notification system (Article 3-1, and removal of Article 4 of the current law). This notification is to be termed a “notification of start of business,” and will include such items as the trade name of the SPC, name of place of business and its location, names of appointed directors and their addresses. Attached to the notification must also be the articles of incorporation, securitization plan, established pledges for assignments of assets and other related contractual documentation (Article 3-2-3). Further, while the inclusion of the securitization plan in the Articles of Incorporation of the SPC is no longer to be required, instead all specified company members⁶ must approve the securitization plan

5 Article 2 of the supplementary provisions to the current SPC Law, which promised the critical review of the effectiveness of the law some 5 years after the enactment, was eventually removed.

6 “Specified Company Members” are those holding an equity interest in the SPC, and as a rule have voting rights on any of the SPC’s actions (usually the originator is a company member). In addition investors in the SPC’s preferred investment securities are “Preferred Investors.”

itself (Article 6). If specified assets are acquired by the SPC prior to the issuance of securities for those assets, then certain items can be omitted from the notification (termed “specified items” the details are to be set out in government ordinances) (Article 7). Furthermore, the minimum capital requirement for an SPC is to be lowered from ¥3 million to ¥100,000 (Article 19).

3) Bankruptcy Remoteness Through Specified Interest Trusts

In order to restrict the voting rights of specified members the new legislation allows specified interests to be held in trust without requiring the approval at a general meeting of those specified members (Article 31-2). In which case the trust contract for those specified interests must meet the following conditions (Article 31-2-2):

- (1) The purpose of the trust is for the management of specified interests in order to facilitate asset securitization via an SPC
- (2) The planned period of the securitization plan is the same as the period of the trust
- (3) The trustee does not receive instructions on how to manage the trust assets
- (4) The trust is not cancelled by the trustee or beneficiary during its period of operation
- (5) The method of management of the trust assets is not changed by the trustee or beneficiary during the period of operation of the trust

Under the current SPC law, though in practice there may be certain cases where it is different, usually the party that sets up the SPC is a specified member of that SPC. As a result the possibility that a credit rating agency might not recognize complete bankruptcy remoteness of the establishing firm from the SPC when specified bonds are issued has been a subject of concern. Here the revised law has therefore introduced the specified interest trust scheme so that a more complete bankruptcy remoteness of the establisher and the SPC assets can be realized.

4) Rights Of Preferred Investors

The revised law will no longer stipulate that preferred investors will automatically have voting rights, in particular over the election or removal of directors, which is currently the main right held by preferred investors in an SPC (Article 65 of the current law to be removed).

It will be possible to state in the Articles of Incorporation that preferred investors may not call a general meeting for the election or removal of directors (Article 54-3).

Further, the new law will allow a rule for consent by default by preferred investors in general meetings. This means that the Articles of Incorporation may state that when preferred investors do not attend a general meeting, or abstain from voting on a resolution, this may be interpreted as their giving consent (Article 60).

Previously the prevailing interpretation was that SPC preferred investors had slightly more comprehensive rights than preferred equity stockholders of a limited company. It has been deemed necessary to amend the law however in order to make comprehensive provision for

the fairness of management decision-making processes, and so that the merits of using an SPC are not lost, as preferred investors are in effect closer to simply pure investors.

5) SPC Operations

As a rule the management and disposal of the specified assets will under the revised legislation be entrusted to a trust bank or similar financial institution (Article 144). Under the current Article 144 the parties engaged in management / disposal of assets are allowed to be (a) the party that has assigned the assets to the SPC, i.e. the originator, and (b) parties possessing the required financial base and human resources to manage / dispose of assets in an appropriate manner, usually a trust bank. However in the case of (a) real estate, (b) specified claims, and (c) registered claims as specified in government ordinances, as per the current law, the originator or any party with sufficient asset administration capability can be entrusted with the management / disposal of the relevant assets (Article 144-4).

While directors and employees of the SPC are to be prohibited from being involved in the marketing / placement⁷ of the ABS (Article 150-2), the assignor (originator) of the assets may however on condition that notification is given to the Financial Reconstruction Commission (Articles 150-3 ~ 150-4).⁸

6) Relaxation Of Restrictions On Borrowing

Under the new law an SPC may borrow funds in order to purchase specified assets if (1) the borrowing limit is stated in the securitization plan, and (2) the lender is a bank or other institution as stipulated by government ordinance (Article 150-6).

It will also be possible for the SPC to fund asset acquisition by issuing convertible bonds and bonds packaged with subscription rights for senior investment securities where this is stated in the securitization plan (Article 113-2 ~ Article 113-5). Issuance of the former is governed by the Commercial Code provisions on convertible bond issues by limited companies, while the latter is governed by the Commercial Code provisions on bonds with subscription rights.

The current law only allows SPCs to borrow funds (Article 151) in very limited circumstances, such as bridging finance prior to issuing ABS. The revised law will however allow loans in addition to corporate debt issues as a permanent method of raising finance. We therefore expect to see SPCs raising funds through a combination of loans and bond issues, depending on amount required and prevailing market conditions.

7 This refers to the regulations on marketing or private placement of securities in the Securities Exchange Law (Article 2-3).

8 Originators involved in marketing / placement of ABS must provide a trading report under the Securities Exchange Law (Article 41), and be subject to regulations governing unfair trading (Article 42) and loss compensation (prohibition of) (Article 42-2).

7) Introduction Of Trust-Type Schemes ~ Special Purpose Trusts

A “Special Purpose Trust” (SPT) is a trust set up under the Asset Securitization Law to securitize assets, with the further purpose of selling to a number of investors shares in trust beneficiary rights held by the beneficiaries at the time the trust deed is concluded (Article 2-12). A plan detailing the core items concerning the SPT’s securitization activities is termed an “Asset Trust Securitization Plan” (equivalent to the asset securitization plans drawn up under current SPC legislation, Article 13). An outline of this scheme is as follows.

(1) Notification and Special Purpose Trust Deed

An SPT deed can be set up by a trust etc. company acting as a trustee (trustee company) through notification with the Financial Reconstruction Commission of an Asset Trust Securitization Plan (Article 164). The SPT deed equates to an SPC’s Articles of Incorporation, and must include an asset trust securitization plan and other requirements (Article 168). The asset trust securitization plan must detail (Article 165): (1) items relating to the duration of the trust deed; (2) items relating to contents and price of assets to be held; (3) items relating to beneficiary certificates (profits disposition etc.); (4) items relating to the management and disposition of assets held; (5) items relating to the trustee company’s borrowing operations.

(2) Assignment of beneficial interests and rights of right-holders

Beneficiary certificates are the only form of security an SPT may issue (Article 173-1). Assignment of beneficial interests is possible, but in the case of registered beneficiary certificates the SPT deed may restrict the assignment to qualified institutional investors⁹ only (Article 172).

The rights of the beneficiaries and trustees of an SPT can only be exercised at a general meeting of voting members (Article 179). The general meeting can nominate one or more voting members who each hold beneficiary certificates worth 1/1000 or more of the principal to make decisions on behalf of the general meeting for non-important issues (Article 193). Consequently if a representative voter is nominated then this representative voter alone can exercise the voting rights belonging to the beneficiaries (Article 195-1). If no representative voter is nominated, the trustee company may elect a specified trust manager to fulfil this role (Article 199).

It is difficult to envisage precisely what form the general meeting will take at this point in time, but considering the significant costs that would probably be involved in convening a meeting of all members, it would seem likely that either a representative voter or a specified trust manager would be nominated.

9 Parties deemed by ordinance of the Ministry of Finance to have the required experience and specialist expertise for investment in marketable securities as defined in Article 2-3-1 of the Securities Exchange Law.

(3) Likely impact of SPTs

Considering the fact that a large number of securitization programs under the Specified Claims Law take the form of trusts, it would seem that the government's aim in establishing an SPT system is for these to be used as vehicles or conduits for trust securitization. There have already been cases where in the securitization of real estate, in order to avoid payment of registration and licensing and real estate acquisition taxes the real estate assets are first put in a trust and the trust beneficiary certificates then sold to an SPC, which serves as a fairly reliable indicator that the planned legislative reforms will provoke substantial interest in programs using SPTs. However company type SPC schemes will still retain certain advantages from the perspective of flexibility and variety of fund procurement channels as they are both able to issue preferred investment securities and in addition after the revised law is passed will be able to borrow funds.

3. Future Outlook

1) ABS Issuance Likely To Increase

The first effect we are likely to see of the new SPC law is a heightening of activity in the ABS market.

The ABS market started in Japan with the enactment of the Specified Claims Law (Law Concerning Regulation Of Business Regarding Specified Claims) in June 1993 with non-banks securitizing their holdings of lease and credit card receivables. This was followed in April 1996 with legislative revision of the Securities Exchange Law enabling the issuance of asset collateralized securities, namely bonds (ABS) and commercial paper (ABCP). The issuance of securitized products under the Special Claims Law then gradually grew with a total of ¥9.5 trillion in funds having been procured by this method by FY98.

The amount of securitized issues so far under the SPC Law however only totals some ¥2 trillion, though considering that this is in the space of only one and a half years it marks considerable growth in the market. However this does not include figures for SPCs incorporated overseas which if taken into account would show that the Japanese ABS market in the wider definition is growing robustly.

Moreover, with the introduction of consolidated and mark-to-market accounting methods and other regulatory reforms over the next few years, the need for companies to realize greater asset efficiency is likely to only increase. If we also consider the remaining large pool of assets which could be securitized and the greater flexibility that companies will have in SPC securitization through ongoing reforms, the securitization market in Japan is in our view set to tread a strong growth path.

2) Accounting Regulations Governing True Sales

Certain ongoing discussions concerning the SPC Law are proceeding outside of the legal arena and have more to do with self-regulation and operational issues.

A case in point is the announcement by the Japanese Institute of Certified Public Accountants (JICPA), in reaction to several cases where credit rating agencies and auditors have taken the view that the sale of assets by the originator to the SPC does not qualify as a “true sale,” of new accounting rules to be introduced possibly as early as August 2000.

The planned new regulations would stipulate that where an originator holds preferred investment securities (equity capital of the SPC) equivalent to 5% or more of the value of the assets to be sold to the SPC, that this would not qualify as a true sale. This was greeted initially with some dismay on the grounds that since a significant proportion of SPC securitization programs were undertaken by listed companies in order to move assets off their balance sheets, few investors would be attracted to more risky senior investment securities, with the number of securitization programs decreasing as a result. However, along with the growth in Japan’s ABS market, it appears institutional investors, struggling to make investment returns against a backdrop of near-zero interest rates, have been turning in increasing numbers to investment in preferred securities. Further, a number of securitization programs that fulfil the JICPA’s proposed new conditions have already appeared giving rise to the counter view that these new rules may not have such a negative impact as was initially feared.

3) New Trends In Securitization

The current set of reforms are testament to the fact that Japan’s securitization market is making progress. Securitization is a major financial market trend that emerged in the US in the 1970s, and has been regarded as an inevitable development for Japan. However indications have begun to emerge that Japan will develop in a different way to the US.

The history of securitization in the US began with Residential Mortgage-backed Securities (MBS or RMBS), after which the experience earned in that field was later applied to the securitizing of car loan and credit card receivables. In the 1990s securitization of commercial real estate loans, previously thought to be too difficult in technical terms, has gradually taken hold spurred by the RTC’s (Resolution Trust Corporation) success in disposing of real estate collateral on bad debts. However in terms of the proportion of the real estate loan market that has been securitized (the securitization ratio), still the securitization ratio of credit and commercial mortgage is far lower than the securitization ratio of residential loans alone.

On the other hand, as mentioned before the Japanese market began with the securitization of lease and credit receivables, and only after came rental receivables on commercial real estate. In Japan the securitization of residential loan receivables in trust form was experimented with but programs abruptly fell off in the 1990s¹⁰, and there have been only a

10 The market in residential loan trusts grew from its inception in 1973 to some ¥400 billion by end FY91. However since then demand for new securitization programs dried up due to two factors: firstly the principal originators of such programs, Japan’s *jusen* residential loan specialists, suffered a slew of bankruptcies; secondly, banks had little incentive to remove these assets from their balance sheets as the BIS risk weighting on residential loans of 50% was in fact lower than regular loans, and further the loans gave the banks high margins.

couple of cases recently of residential loan ABS schemes.¹¹ In order to predict the likely future course of the Japanese securitization market it is first necessary to fully grasp the differences with the US both in terms of the nature of financial transactions and the structure of their financial markets.

In our view, necessary preconditions in order for the securitization market in any particular asset type to take off are: (1) a dearth of credit available from traditional lenders in that sector; (2) an investor base seeking high returns; (3) the potential to earn adequate profits for the arrangers of securitization schemes (investment banks); (4) regulatory authorities and lawmakers who are prepared to promote securitization through the legislative system. This shows that reform of the legal infrastructure alone is not enough: a financial market environment where each player has an incentive to securitize needs to exist. After the current SPC reforms have been passed, the role of financial institutions in seeking out new securitization requirements and enabling these to be carried out is likely to grow significantly in importance.

11 It will be interesting to see how the upcoming planned MBS issue of Japan's Housing Loan Corporation will fare (this constitutes a pool of loans made during FY00 against which the corporation plans to issue around ¥50 billion in MBS over February ~ March 2001).