

# General update on the Japanese securitisation market

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THIS UPDATE PROVIDES AN OVERVIEW OF THE SECURITISATION MARKET IN JAPAN AND ITS RECOVERY EFFORTS SINCE THE GLOBAL FINANCIAL CRISIS. DESPITE AN INCREASE IN OPTIMISM BROUGHT ABOUT BY ABENOMICS, JAPANESE COMPANIES STILL HAVE DIFFICULTY RAISING CAPITAL, WHICH HAS LED TO THE EMERGENCE OF NEW SECURITIES STRUCTURES SUCH AS INFRASTRUCTURE FUNDS. THIS HAS AT LEAST IN PART CONTRIBUTED TO CERTAIN LEGISLATIVE ACTIONS, FOR EXAMPLE, ALLOWING PUBLIC FACILITIES TO GRANT CONCESSION RIGHTS AND THE INTRODUCTION OF J-REITs. THE TOKYO STOCK EXCHANGE ALSO RECENTLY ANNOUNCED AN INFRASTRUCTURE STOCK FUND MARKET, ENABLING INVESTMENT TRUSTS TO LIST THEIR EQUITY SECURITIES ON THE MARKET.

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## General update on the securitisation market in Japan

Before the global financial crisis of 2008, the securitisation market in Japan was very-well developed both in terms of sheer volume and sophistication. By way of example, in 2006, the actual issuance of securitisation products on an announced basis reached about JPY11 trillion. However, following the global financial crisis originating from the subprime mortgage crisis, the demand for securitisation products decreased (despite no critical issues having arisen relating to the products themselves in the Japanese market, save for certain defaults of commercial mortgage-backed securities (CMBS) transactions that had resulted primarily from the reduction in the number of non-recourse real estate financing providers, and the general unwillingness to provide credit support for real estate financing). Although, the tightening of the treatment of (re)securitisation products in the Basel accord might have had a negative impact on revitalising securitisation in Japan.

Since the start of 2008, the scale of securitisation business shrunk so much that, during 2009-13, the actual issuance of securitisation products per year on an announced basis was only between JPY3 trillion to JPY5 trillion (not including J-REITs (Japanese real estate investment trusts)).



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Nevertheless, various industry sectors have picked up some momentum and are showing signs of optimism due to the application of “Abenomics”; the pro-growth policies focused on pulling the Japanese economy out of deflation, of the Prime Minister, Shinzo Abe. The Liberal Democratic Party again decisively won the election of members of the House of Representatives in December 2014, so it is expected that “Abenomics” will continue.

In spite of the above, with the rate of capital from the Bank of Japan (BOJ) still set low, more companies are finding it difficult to raise capital on favourable terms in the bond and commercial papers markets, when compared to interest rates on corporate loans extended by Japanese banks. As a result, banks have actively extended straight corporate loans. Larger Japanese banks are still active in refinancing commercial mortgage loans, and buyout related financing transactions, as other debt-investors’ capital is not currently sufficiently flowing in the way it had prior to the global economic crisis.

However, residential mortgage-backed securities (RMBS) originated by the Japan Housing Finance Agency (JHF RMBS) continue to be steadily issued. In addition, new structures have emerged recently, including, for example, (i) securitisation transactions using a declaration of trust by the originator; (ii) new structures using the TMK scheme have developed under eased regulations and requirements introduced by statutory reforms; and (iii) a new scheme using the TK-GK under the recently amended Real Estate Specified Joint Enterprise Act.

Of the total volume of issued securitisation products, those originated by government-affiliated institutions have made up approximately half of the total issued amount for the past several years. The remainder seem to originate mostly from consumer credit companies, banks and leasing companies.

## Turning focus to infrastructure funds?

### Introduction and background

As everyone is aware, Japan experienced extremely rapid economic growth after World War II and during that growth

period, public facilities and infrastructure such as highways, tunnels, dams, power-plants, airports, schools and hospitals were constructed throughout Japan. Since the growth was so rapid, much of this infrastructure and public facilities was constructed within a fairly short amount of time. While they were state-of-the art at the time, with the passing years, we are starting to face the need to reconstruct, rebuild, renovate and/or refurbish many of these facilities also in a fairly short amount of time, hence calling for massive amounts of financing. However, with the government facing its own financial restrictions, there has been an increasingly growing sense of need to tap private sources of financing and operational know-how over the last 10 to 15 years.

Another backdrop to the increasing attention to infrastructure funds is the Fukushima nuclear power-plant crisis in 2011. The crisis has brought about an increasing interest in renewable energy and with the government’s support via grant money in the form of subsidisation, many so-called mega-solar power plants have been and are being built throughout Japan in the last few years. And with the stable cash-flow based on the subsidisation, there is a growing belief that interests in mega-solar power plants and other renewable energy projects are suitable for financing through listing on the stock exchange.

### Legislative actions

With this background, the government took certain legislative actions. The first was the introduction of the “concession method” as a method of PFI, i.e. private-finance initiative that is typically governed by the Act on Promotion of Private Finance Initiative (the so-called “Japanese PFI Law”). This Act allowed governmental bodies or public entities to retain the ownership of public facilities or infrastructure but grant “concession rights” (i.e. the right to operate public facilities or infrastructure) to private enterprises in consideration for usage fees. Secondly, the Act on Investment Trusts and Investment Corporations (which is the so-called Japanese REIT statute) was amended to allow investment trusts and investment corporations, or J-REITs, to own and hold (a) those “concessions rights” as well as (b) rights in certain

qualified renewable energy power-plants, so that the investors in J-REITs may invest in them. While no tax benefits are afforded to J-REITs that invest in concession rights (unless other invested assets call for tax benefits), in the case of rights in certain qualified renewable energy power-plants, they do count towards the threshold requirement for pass-through tax treatment.

### Stock exchange

As recently as April 30, 2015, the Tokyo Stock Exchange announced and launched its infrastructure fund market. This followed the discussions of the “Study Group on the Listed Infrastructure Market” comprised of academics and professionals, and in light of increasing demand for investing in infrastructure and the social significance of infrastructure development as described above.

The basic structure of infrastructure funds is the same as J-REITs, in that either investment trusts or investment corporations established or incorporated under the J-REIT statute will list their equity securities on the market, save for a distinctive characteristic featuring the requirement for an “operator” being appointed to operate the relevant public facilities and/or infrastructure. Infrastructure funds that are eligible to list their equity securities are those funds that invest primarily in either rights in certain qualified renewable energy power-plants or concession rights in public facilities or infrastructure described above.

While we have yet to see an infrastructure fund that has actually listed on the market, a considerable number of Japanese corporations (including fund managers and real estate developers) have already publicly announced their desire and intention to establish a fund with the aim to list on the market.

### Other noticeable developments

#### The “risk retention” requirement under the FSA’s rules

As is the case in other advanced countries, Japanese financial institutions, including not only banks but also securities firms and insurance companies, are subject to

capital adequacy requirements under various governing/regulating statutes (such as the Banking Act), which are based on the rules set out under the Basel III Accord or at least similar rules. These financial institutions make use of securitisation transactions to reduce their own risk assets to gain capital relief. Therefore, if capital adequacy requirements are substantially modified, these modifications will affect securitisation transactions originated by these financial institutions.

In relation to this, it is noteworthy that the Financial Services Agency of Japan (the “FSA”), the regulating governmental body supervising and regulating financial institutions, has proposed and implemented amendments to the supervisory guidelines. Under these amendments, financial institutions will be reviewed during the course of the regulators’ inspections to check whether they are adequately monitoring and accounting for risk retentions by the originators when they invest in securitisation products. Unlike in the EU or the US, risk retention requirements directly subjecting originators to retain a certain proportion of the risk have not been introduced in Japan, and the indirect approach as noted above has been adopted. The FSA has also announced and effected its proposed amendment that effectuates and implements LCR (liquidity coverage ratio) regulations on financial institutions, and risk retention rules are indirectly included therein as, for example, RMBSs held by financial institutions are counted as eligible assets if risk retention measures are implemented in the jurisdiction of origin.

#### Movement in terms of asset classes

Recently, a large proportion of securitisation products in Japanese markets have involved residential mortgage loans. RMBS are the most frequently issued products, which are issued for the purposes of capital relief rather than financing. While many commercial mortgages, auto loans, consumer loans, lease payment and credit card receivables have been, and are still being, securitised (typically to gain alternative financing for the originators), the market size of securitisation of these receivables has shrunk since the beginning of 2008.

The market frequently has seen repackaging products that re-securitise existing securitisation products as underlying assets, including a CDO-squared (that is, CDOs that are re-securitised as underlying assets). In addition to those products, securitisation of asset classes known as exotic assets, such as receivables relating to franchise guarantees, can also be seen. And, while the market appetite for new asset classes has deteriorated and the eagerness for the introduction of securitisation transactions involving new asset classes has drastically decreased following the market turmoil that began in 2008, it is noteworthy that the market saw the first listed healthcare J-REIT in March 2015. Unfortunately, however, debt financing of the healthcare J-REIT as well as other healthcare related funds (and for that matter, infrastructure funds that are starting to gain momentum as described above) are yet almost exclusively achieved through bank loans (as opposed to bonds or other debt instruments through direct market financing).

### Civil Code reform

Discussions in the government are ongoing in relation to an announced plan for substantial amendments to the Civil Code (particularly the laws relating to contractual rights and obligations), although the effect these amendments will have on securitisation transactions will be limited.

The discussions of the Legislative Council of the MoJ on the Civil Code are now considered to be at the final stage, and

the Council will probably present a draft of the reform to Congress within 2015. In relation to financial transactions, the current published draft includes some important amendments such as (i) changing the public interest rate from a fixed rate to a floating rate; (ii) reinforcement of the protection of individual guarantors; (iii) changing the period of the statute of limitation; and (iv) changes with respect to the transfer of claims.

### Others

The amendment of the Company Act was passed in June 2014 and will be effective sometime in 2015, which includes important matters regarding capital markets. In addition, in relation to capital markets, the Stewardship Code was introduced by the Japanese FSA, and in this connection, the Tokyo Stock Exchange published a preliminary draft of the Corporate Governance Code in 2014.

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