



# The Amendment to the Money Lending Law Will Affect Consumer Loan Securitizations

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**O**n October 31 2006, the bill for the Partial Amendment to the Money Lending Law was laid before the national parliament.

The bill provides for the following main amendments:

- (i) tightening requirements for registration as a money lender,
- (ii) strengthening the functional capability for self-regulation of money lenders' associations,
- (iii) strengthening the regulation of money lending (including regulations on the collection and obligation to deliver, in advance, documents stating the aggregate amount of principal and interest, etc.; prohibiting the entrustment of public notaries to draft notarized documents about agreements that state interest exceeding the interest limits stipulated in the *Interest Limitation Law (Risoku Seigen Ho)*; creating an obligation to explain to joint and several guarantors that they do not have any defence in the form of requesting the lender to ask the borrower first; and requesting the lender to enforce against the borrower's assets),
- (iv) introducing business improvement orders,
- (v) creating specified credit record institutes,
- (vi) introducing total amount control (creating the obligation to investigate borrowers' debt-paying capacity and prohibiting the lending of money in excess of borrowers' debt-paying capacity), and
- (vii) lowering the interest cap (abolishing valid interest payments, gray-zone interest and lowering the interest cap under the *Investment Deposit and Interest Rate Law (Shussi Ho)*).

Under the amendments mentioned above, lowering the interest cap is expected to attract much general attention. Although the *Interest Limitation Law* states that agreements on interest exceeding the interest cap are invalid, the *Money Lending Law (Kashikin Gyo no Kiseito ni Kansuru Horitsu)* states that if a money lender agrees with a borrower on interest exceeding the interest cap under the *Interest Limitation Law* and the borrower pays the interest at his own discretion, the payment of interest shall be deemed valid under certain conditions (including if the interest does not exceed the interest cap under the *Investment Deposit and Interest Rate Law*, and the lender performs the obligation to deliver relevant documents under the *Money Lending Law*). It is reasonable that the *Investment Deposit and Interest Rate Law* imposes no penalty on money lenders unless their agreement of interest exceeds the legal interest cap. Interest exceeding the interest cap under the *Interest Limitation Law*

and not exceeding the interest cap under the *Investment Deposit and Interest Rate Law* is called gray-zone interest, in that the interest is invalid under the *Interest Limitation Law* but may be deemed valid under the *Money Lending Law* (or is not subject to penalty under the *Investment Deposit and Interest Rate Law*).

In securitization transactions conducted up to now, gray-zone interest has depended on the transaction. Accordingly, if the bill passes and the provision deeming payments of interest exceeding the cap under the *Interest Limitation Law* to be valid is abolished, the cash flow generated by the interest will not be paid to investors thereafter. However, it is expected that because in consumer loan receivables securitization transactions cash is usually reserved for paying borrowers where the borrowers demand the return of deemed valid interest, the abolishment of deemed valid interest payments will not directly affect the cash flow in securitization transactions to a great extent.

However, abolishing the provision that deems payments of interest exceeding the interest cap under the *Interest Limitation Law* to be valid would affect the financial conditions of originators. In Japanese monetary claim securitization transactions, originators usually act as the servicer of securitized monetary claims; thus, the deterioration of an originator's financial condition means the deterioration of the servicer's condition. In cases in which an originator, as a servicer, is replaced with another party (including a backup servicer) because of deteriorating financial conditions, the replacement would incur expenses due to transferring the servicing business from the originator to the other party, and the new servicer would not be able to collect at the same level as the originator because the new servicer is less familiar with the borrowers and does not have the necessary know-how. For this reason, the replacement of the servicer would affect the cash flow generated by the securitization products. Accordingly, abolishment of the provision deeming payments of interest exceeding the cap to be valid would indirectly affect securitization transactions.

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