Secured Transactions Law Reform in Japan: Japan Business Credit Project Assessment of Interviews and Tentative Policy Proposals

Megumi Hara  
*Gakushuin University*

Kumiko Koens  
*Yamagata University*

Charles W. Mooney Jr.  
*University of Pennsylvania Carey Law School*

Follow this and additional works at: [https://scholarship.law.upenn.edu/faculty_scholarship](https://scholarship.law.upenn.edu/faculty_scholarship)

Part of the Banking and Finance Law Commons, Commercial Law Commons, Comparative and Foreign Law Commons, Corporate Finance Commons, Economic Policy Commons, Finance Commons, Japanese Studies Commons, Law and Economics Commons, Law and Society Commons, Legislation Commons, Policy Design, Analysis, and Evaluation Commons, Political Economy Commons, and the Secured Transactions Commons

**Repository Citation**

[https://scholarship.law.upenn.edu/faculty_scholarship/2266](https://scholarship.law.upenn.edu/faculty_scholarship/2266)

This Article is brought to you for free and open access by Penn Law: Legal Scholarship Repository. It has been accepted for inclusion in Faculty Scholarship at Penn Law by an authorized administrator of Penn Law: Legal Scholarship Repository. For more information, please contact PennlawIR@law.upenn.edu.
SECURED TRANSACTIONS LAW REFORM IN JAPAN:
JAPAN BUSINESS CREDIT PROJECT ASSESSMENT
OF INTERVIEWS AND TENTATIVE POLICY PROPOSALS

Megumi Hara, Kumiko Koens, and Charles W. Mooney, Jr.*


I. INTRODUCTION

II. OVERVIEW OF RELEVANT SECURED TRANSACTIONS LAWS IN
JAPAN

III. KEY FINDINGS

A. Collateral for Loans: Practices, Attitudes, and Experiences

B. Causes and Effects of Limited Use of ABL

1. Perception that Benefits of ABL Are Limited: Low Interest
   Rates, Low Default Rates, General Availability of Credit

2. Reliance on Immovables Collateral

3. CGC Guarantees

4. Costs of ABL

a. Shihō Shoshi

* Hara is Professor of Law, Gakushuin University Law School; Koens is Professor, Faculty of Literature
   and Social Sciences, Department of Public Policy and Social Studies, Yamagata University; and Mooney is
   Charles A. Helmbold, Jr. Professor of Law, University of Pennsylvania Law School. Thanks for comments
   and suggestions to participants at the Japan Registration Society Annual Conference (JRS Conference),
   Tokyo, 28 November 2020, at which Professor Koens presented some of our preliminary findings. The
   authors also express their gratitude to the following organizations for funding or other support for the Japan
   Business Credit Project: JSPS KAKENHI Grant[s] [Numbers 15H01917, 18K01343, and 20H00051];
   grant-in-aid from Zengin Foundation for Studies on Economics and Finance; Egusa Foundation for
   International Cooperation in the Social Sciences; Abe Fellowship provided by Japan Foundation, Center for
   Global Partnership and Social Science Research Council; Gakushuin University (Faculty of Law and Law
   School); Waseda University (Law School); Hokkaido University (Law School); University of Pennsylvania
   (Carey Law School); Yamagata University.
b. Valuation of Collateral

c. Administrative Costs and Burdens

5. Issues Related to Legal Infrastructure
   a. Private law of Secured Transactions
   b. Regulatory Treatment of ABL

6. Stigma, Reputation, and Borrower Attitudes

7. Lack of Secondary Market for Movables

8. Non-Assignability: Anti-Assignment Clauses and Other Restrictions.

9. Enforcement Challenges (including Limited Use of Insolvency Proceedings)

10. Need for Capacity Building

IV. SECURED TRANSACTIONS LAW REFORM IN JAPAN:
    ASSESSMENT AND TENTATIVE PROPOSALS

A. Principal Proposed Reforms
   1. First-to-Register Priority Rule
   2. Simplifying Descriptions of Collateral
   3. Addressing the “Overcollateralization” Doctrine
   4. Addressing the “Crystallization” Doctrine
   5. Applicability of PRAMC to Individual Assignors.
   6. Insolvency Law Reforms (Including Automatic Stay and Relief From Stay)

B. WBG Ranking and Additional Reforms
1. “All Assets” Collateral

2. Generally Applicable PRAMC Registry for All Debtor Entities.

3. “Notice-Based” Registration and Transactional Scope of PRAMC Registration System

4. Online Access to Registry and Third-Party Searches

5. Products, Proceeds, and Replacements of Collateral

6. Automatic Stay and Relief from Stay in Court-Supervised Reorganization Proceeding


C. Other Law Reforms.

V. POTENTIAL IMPACT OF SECURED TRANSACTIONS LAW REFORMS IN JAPAN

A. Valuation-based ABL (e.g., Valuation of Borrowing Base of Inventory and Receivables)

B. Lender-Borrower Relational-Based Secured Financing

C. Monitoring of Borrower vs. Monitoring of Collateral

D. Examples: Financing Patterns in United States

E. Significance of Secured Transactions Law in Post-COVID 19 Economy

F. Overarching Impact of Reforms

1. Facilitating Credit

2. Secured Transactions Law as a Simplified, Coherent, and Flexible “Toolkit”
VI. OBSERVATIONS ON THE ROLE OF QUALITATIVE EMPIRICAL RESEARCH AND LAW REFORM

VII. SUMMARY AND CONCLUSION

* * * * *

I. INTRODUCTION

Our Japan Business Credit Project (JBCP) began in 2016 with several preliminary interviews of bank staff, bengoshi (lawyers) and shihō shoshi (judicial scriveners), regulators, and ministry officials. The original focus was primarily on the Act on Special Provisions, Etc. of the Civil Code Concerning the Perfection Requirements for the Assignment of Movables and Claims (PRAMC). Our goals were to examine Japanese law on secured transactions for movables (business inventory and equipment) and claims (receivables), including PRAMC, in order to provide a policy critique and to offer suggestions for revisions. In 2017 we substantially expanded the project to embrace a broader survey of Japanese business credit markets, while retaining the principal focus on asset-based lending (ABL) and registration of assignments under PRAMC. In this article we adopt the (albeit somewhat imprecise) definition of ABL generally used in Japan—loans secured by movables (typically inventory) and claims (receivables).

We now have conducted more than 30 interviews, including those with staff of city banks in Tokyo and local and regional banks in six prefectures outside of Tokyo. We also participated in (and served on the organizing committee for) an invitational conference that focused on secured transactions law reform in Japan held in Tokyo in July 2018. In the meantime we have supplemented and updated the interview data with several informal consultations. The principal goal of this article is to summarize our key findings from the interviews and informal consultations.

This is a propitious time for publication of these findings. This is so primarily because three committees with government connections recently have been studying the

---

1 Dōsan oyobi Šaiken no Jōto no Taikō Yōken ni kansuru Minpō no Tokurei tō ni kansuru Hōritsu [Act on Special Provisions, etc. of the Civil Code Concerning the Perfection Requirements for the Assignment of Movables and Claims], Law No. 104 of 1998 as amended and renamed by Law No. 148 of 2004 (Japan) [hereinafter PRAMC].
2 There are various views in Japan as to the scope, meaning, and appropriate use of the term “ABL.” The views differ primarily as to the emphasis and reliance that a lender may place on valuations of collateral as significant means of repayment. Because principal interest here is the legal framework for the use of movables and claims as collateral, this broad and general definition is most appropriate.
3 The conference was sponsored by Gakushuin University Law School, Bank of Japan (Institute for Monetary and Economic Studies), Nishimura & Asahi, and University of Pennsylvania Law School.
4 The Committees are: Dōsan Saiken wo Chūshin toshita Tanpo-Hōsei ni kansuru Kenkyūkai (Research Group on Security Interest Regime Mainly for Goods and Receivables) which involves the Ministry of Justice (MoJ), and is headed by Professor Hiroto Dogauchi; Torihiki Hōsei Kenkyūkai (Research Group on Business Law) which involves the Small and Medium Enterprise Agency under the Ministry of Economy,
possibility of changes to the secured transactions framework for movables and claims.\(^5\)
For that reason we address here primarily our findings bearing most directly on potential
secured transactions law reforms and offer some useful perspectives on the various policy
choices involved in considering secured transactions law reforms in Japan. We hope that
this report on our findings will be influential on the substance and ultimate enactment of
law reforms.\(^6\) For readers who may lack the specialized knowledge and experience of the
committee members, we also hope that this article will offer some useful perspectives on
the various policy choices involved in considering secured transactions law reforms in Japan.

Our discussion of potential law reforms also provides at least a brief glimpse the
emerging modern principles of secured transactions law, as reflected by instruments such
as the UNCITRAL Model Law on secured transactions and related UNCITRAL texts.\(^7\)

---

\(^5\) As of February 2021, the Minister of Justice consulted with the Legislative Council of the MoJ, which is
the official council to formulate a draft, to deliberate on drafting secured transactions frameworks for
movable assets. In response to this consultation, a working group dedicated to this mission has officially
been launched. It is expected that the report of the study group involving MoJ will be the starting point in
the deliberation of the working group.

\(^6\) UNCITRAL Model Law on Secured Transactions (2016) [Model Law].
http://www.uncitral.org/pdf/english/texts/security/ML_ST_E_ebook.pdf. The Model Law was inspired by
its predecessor, UNCITRAL Legislative Guide on Secured Transactions (2007) [Secured Transactions
One of us has summarized the modern principles as follows:
(i) public notice as a general condition for third-party effectiveness (perfection), including (x) a
grantor identifier-based registry for registration of notices of security interests, and (y)
possessing of tangible assets;
(ii) clear and easy to achieve methods for creation of security interests;
(iii) clear and predictable priority rules, including the general effectiveness of security interests
in insolvency proceedings and priority of security interests over other interests;
(iv) provision for effective enforcement of security interests following a debtor’s default,
including extrajudicial enforcement;
(v) availability of all types of personal property as collateral, including future assets securing
future obligations;
(vi) free assignability of receivables;
(vii) comprehensive coverage of all forms of security devices;
(viii) extension of security interests to the proceeds of collateral;
(ix) the general acceptance of freedom of contract for inter-party relations;
(x) general equality of treatment of creditors providing acquisition financing; and
In that context we hope to dispel the simplistic and unfortunate stereotype that laws based on the modern principles necessarily lead to financing patterns involving a single dominant secured creditor.

Part II of the article provides an overview of Japanese secured transactions law. It sets the stage and provides context for the problems identified and the reforms proposed here. Part III identifies and describes the key findings of our study. Part IV then proposes several Japanese law reforms that address the principal problems with the prevailing legal framework for secured transactions. Part V considers the potential impact of the proposed reforms. Part VI offers our brief assessment of the value and significance of academic research such as the JBCP, which employ qualitative empirical studies of actual practices and prevailing attitudes and assumptions among market participants. Part VII concludes the article.

II. OVERVIEW OF RELEVANT SECURED TRANSACTIONS LAWS IN JAPAN

This Part provides a brief overview of selected aspects of Japanese law relating to secured transactions in movables and claims—the subjects of ABL in Japan. It first addresses issues of private law, such as the effectiveness of security interests between the parties and as against third parties (including buyers from debtors), issues of public policy, and enforcement. It then considers the role of public guarantees in business credit and certain bank regulatory considerations. The summary is not comprehensive but focuses primarily on the legal aspects that were significant topics of discussion in our interviews.  

ABL transactions in Japan are primarily structured as title-transfers for purposes of security—jōto tanpo. Case law supports the effectiveness of jōto tanpo secured transactions. As to the validity of a jōto tanpo title transfer there are no specific statutory requirements. But general contract law requires an appropriate level of certainty as to the property covered and the obligations that are secured. Providing an adequate description is particularly problematic for the inventory and receivables of a business enterprise. Because inventory is continually acquired and sold and receivables are continually generated and collected, they are always in a state of flux. It is essential as a practical matter that a description adequately cover a debtor’s future inventory and receivables. Although the Supreme Court has provided some useful guidance as to the adequacy of these descriptions, the requirements remain somewhat unclear. For example, although inventory may be understood conceptually to be an “aggregate” and it is not necessary to

(xi) clear private international law (choice-of-law) rules.

8 For a more comprehensive general summary of Japanese secured transactions law, see Megumi Hara, Navigating the Patchwork of Secured transactions Rules in Japan: Towards a Framework Conducive to Asset Based Lending, in SECURED TRANSACTIONS LAW IN ASIA: PRINCIPLES, PERSPECTIVES AND REFORM 173 (Louise Gullifer & Dora Neo eds., forthcoming 2021).

9 See generally id., 181.
describe each separate item it still must be identified by “kind, place and quantitative range.”

There are standards of specificity for a debtor’s future receivables as well.

The use of jōto tanpo is particularly important for movables, such as inventory and equipment, because the creation and third-party effectiveness of a statutory pledge of movables under the Minpō (Civil Code of Japan) requires a delivery to the pledgee (creditor) and the pledgee’s continuous possession of the movables. Obviously, a pledge is not practical in the case of business movables which normally must remain in the possession of the debtor. However, compliance with requirements for third-party effectiveness under of the Minpō is more easily achieved for jōto tanpo than for a statutory pledge. Such effectiveness may be achieved by a so-called “fictitious delivery” to the creditor, which involves the debtor’s declaration that it holds possession of the movables as agent for the creditor. Such a constructive change of possession is sometimes supplemented by a physical plate or sign attached to the movables indicating that a delivery pursuant to a jōto tanpo transaction has occurred and exists. Unlike for movables, a statutory pledge of receivables is not impractical. But the use of jōto tanpo for ABL involving receivables is the norm nonetheless.

Registration of assignments under PRAMC offers an alternative method of obtaining third-party effectiveness for jōto tanpo assignments of movables or

12 We do not consider here the various special laws that apply to security interests in certain movables, such as agricultural goods (Agricultural Goods Credit Act, 1933), cars (Car Mortgage Act, 1951), aircraft (Aircraft Mortgage Act, 1953), ships (Commercial Code, Art 848), and construction machines (Construction Machine Act, 1954). See generally, Hara, supra note 8, at 176, 179.
13 See MINPŌ [CIVIL CODE] art. 352 (Japan).
14 MINPŌ (CIV. C.) art. 183. The effectiveness of such a delivery for purposes of third-party effectiveness for jōto-tanpo was approved by the Japanese Supreme Court. Saikō Saibansho [Sup.Ct.] June 2, 1953, no.952,9 [MINSHŪ] 855. However, Professor Ikeda has expressed the view that a “fictitious” delivery under Minpō article 183 should not be considered a “delivery” under article 178 for purposes of third-party effectiveness. See, Masao Ikeda, Dōsan- Saikentanpo no Tenkai to Kadai, Hanrei Taimuzu [HANTA] Vol. 1202, 27, 28-31 (2006); Masao Ikeda, Dōsan Saiken Tōkino Mirai-Hōkoku no Sōkatsu ni Kaete, Tōkijoho Vol, 689, 24, 25 (2019). Another view favors creation of a registration system that would be limited to jōto tanpo security interests and, unlike the PRAMC system, would not apply to outright transfers of movables). TAKASHI UCHIDA, MINPO III 636 (4th ed. 2020).
15 Hara, supra note 8, at 177-78, 183 n. 31.
16 MINPŌ (CIV. C.) arts. 364 (pledge), 467(2) (assignments generally). The effectiveness of a pledge or assignment as against the obligor is not subject to the “fixed date” requirement. MINPŌ (CIV. C.) art. 467(1).
17 Although PRAMC applies to any assignment of movables or claims within its scope (including an outright title transfer, e.g., a sale), in practice it is used primarily for jōto tanpo assignments.
receivables made by juridical persons, such as corporations. Registration of assignments may be made at only one location, the Legal Affairs Bureau Office in the Nakano Ward in Tokyo, although the registry is accessible online. PRAMC supplements the Minpō provisions on third-party effectiveness by providing that registration of an assignment of movables is deemed to be a delivery of the movables that satisfies the Minpō condition for effectiveness. In like fashion, registration of an assignment of claims is deemed to be a notification bearing a fixed date that renders the assignment effective against third parties other than the obligor. Effectiveness of a registered assignment against the obligor on a claim may be accomplished by the delivery to the obligor of an official certificate of the registration (a “Certificate of Registered Matters”) or by the obligor’s acknowledgment of the assignment and its registration.

The PRAMC registration system provides public notice of assignments as a useful alternative to the Minpō methods for third-party effectiveness of assignments of movables and claims. However, the parallel and co-existing Minpō and PRAMC methods are problematic in the setting of priority. Under the applicable first-in-time principle, for example, an earlier-in-time transfer made effective under a Minpō method would have priority over a subsequently registered assignment. However, such an earlier unregistered assignment would not be reflected by a search of the PRAMC registry.

For purposes of registration, PRAMC requires applications for registrations to identify the assigned movables and assigned claims as specified in an ordinance of the Ministry of Justice. For example, movables may be identified by the type or kind involved or by the kind and the location, but the level of specificity is unclear. Similarly, claims may be described by type, the underlying contract, and time of accrual and, if the obligors are identified, the number and amount of the claims. When the obligors are not identified the attributes of the obligors must be specified but the amounts

---

18 PRAMC art. 1.
19 See PRAMC art. 5(1) (registry office to be designated by Ministry of Justice). The Tokyo Legal Affairs Bureaus is designated by MOJ Notification No. 501 (September 30, 2005). The Registration Department (responsible for registration of assignments of movables and receivables under PRAMC) is located in The Nakano Branch Office of the Tokyo Legal Affairs Bureau. See also Organizational Regulation for Legal Affairs Bureaus, arts. 14, 18-2, 19.
20 PRAMC art. 3(1) (registration deemed to be delivery under MINPÔ (CIV. C.) art. 173); MINPÔ (CIV. C.) art. 178 (delivery is requirement of third-party effectiveness of transfer of movables). In practice, creditors that register assignments of movables typically also receive a fictitious delivery under the Minpō, inasmuch as the marginal cost of doing so is minimal. See supra note 14.
21 PRAMC art. 4(1) (registration deemed to be notification bearing fixed date per MINPÔ (CIV. C.) art. 467).
22 PRAMC art. 4(2) (delivery of Certificate of Registered Matters and acknowledgment of registration); art. 11(2) (request for Certificate of Registered Matters).
23 Searches by third parties that are not associated with an assignment (such as the assignor and assignee, an attaching creditor, or obligor on a claim), however, do not reveal a description of the property assigned. See infra Part IV.B.4.
25 PRAMC art. 7(2)(v) (movables), art. 8(2)(iv) (claims); Ordinance No. 39 (1998) art. 16 (movables), art. 19 (claims).
26 For detailed analysis of requirements of specificity, see Osamu Morita, Saiken Kaishū Hō Kögi (The Law of Debtors and Creditors : Strategic Approach) (2d ed. 2011) 147-152.
27 Ordinance No. 39 (1998), art. 9(1)(ii).
We discussed above the need for specificity and the attendant legal uncertainty with respect to the description of property that is necessary for a valid assignment. In general, similar ambiguities and lack of clarity exists with respect to descriptions necessary to meet the PRAMC registration requirements.

Even if the description were sufficient for purposes of validity of a jōto tanpo assignment under the Minpō and PRAMC registration, a decision of the Supreme Court suggests that the assignment might not be enforceable on grounds of public policy. The issue is typically described as one of “overcollateralization” that would result from a description of assigned property that covers substantially all of a debtor’s assets. The basis of the public policy concerns expressed by the Supreme Court include excessive restrictions on the assignor’s business activities beyond socially acceptable norms and unjust disadvantages to other creditors resulting from an assignee’s absolute control over all of the assignor’s assets.

The interest of a jōto tanpo assignee may be subject to the rights of buyers of assigned movables in some circumstances. The Supreme Court has recognized that a buyer of inventory in the ordinary course of the assignor’s business will take free of the interest of a jōto tanpo assignee. The assignee is understood to have authorized such expected, ordinary course dispositions. As to other dispositions by the assignor outside of the ordinary course, a buyer may take free of the jōto tanpo assignee’s interest if the requirements of bona fide acquisition under the Minpō are met—i.e., if the buyer acts in good faith and without negligence.

It is unclear whether and under what circumstances a buyer who fails to search the PRAMC registry would be acting in good faith and without negligence so as to take free of a registered assignment, however.

It is generally understood that enforcement of a jōto tanpo assignment requires strict identification of the assigned property against which enforcement is to take place. This is especially significant for property that fluctuates, such as inventory. The understanding of such fluctuating assets as an aggregate gives rise to the conceptual and theoretical basis for what is sometimes referred to as “crystallization.” For example,

---

28 Ordinance art. 9(1)(iii).
30 For example, a typical description for purposes of creation and public notice (filing) under the Article 9 of the UCC in the United States would be “all of debtor’s inventory, equipment, and accounts now owned or hereafter acquired.” See UCC § 9-502(a)(3) (financing statement must “indicate the collateral covered by the financing statement”); 9-203(b)(3)(A) (unless secured party is in possession or control of collateral, security agreement must “provide a description of the collateral”); 9-108(a) (security agreement description must reasonably identify the collateral), (b)(2) and (3) (identification of collateral may be by “category” or “type of collateral defined in” the UCC); STEVEN L. HARRIS & CHARLES W. MOONEY, JR., SECURITY INTERESTS IN PERSONAL PROPERTY (6th ed. 2016) 181-84 (indication of collateral in financing statement), 149-51 (description of collateral in security agreement).
31 See infra discussion of overcollateralization in Part V.
33 MINPÔ (Civ. C.) art. 192.
34 See Hara, supra note 8, at 189.
crystallization may be seen as a “screenshot” of the aggregate body of inventory at a particular time that defines the aggregate property that is the subject of enforcement. If an item of inventory is transferred outside the ordinary course of business before crystallization (while it is a part of the “aggregate”) it might be clawed back, subject to the rights of a good faith acquirer. On the other hand, once crystallization occurs there would be no further fluctuation—subsequently acquired inventory would not be a part of the collateral even though it would otherwise be covered by the earlier assignment. Notwithstanding these understandings, the status of crystallization is necessarily uncertain because it has not been addressed by the Supreme Court.

Provisions in contracts that prohibit or otherwise restrict the assignment of rights to payment (anti-assignment clauses) have impeded jōto tanpo assignments of receivables, but recent legislation (effective on April 1, 2020) promises to reduce the burdens created by these restrictions. While this legislation has usefully reduced the negative impact of these provisions, some difficulties persist.

Prior to the effectiveness of the new legislation an assignment in violation of an anti-assignment clause (even if otherwise effective against third parties under the Minpō or PRAMC) generally was ineffective. The proprietary impact of the no-assignment clause was that the putative assignee would receive no interest in the subject receivable (although there were limited exceptions to this result). Under the revised law, however, the receivable can be effectively assigned and the assignment will be effective notwithstanding an anti-assignment clause. Consequently, an assignee’s interest could achieve priority over a later-in-time assignee or attaching judgment creditor.

Notwithstanding these benefits of the new law, some problems remain that will hinder the use of assignments of receivables as collateral. The new legislation does not render anti-assignment clauses invalid or unenforceable as against the assignor. It follows that an assignment in violation of such a provision may result in a breach of contract and a claim for damages or even termination of the underlying contract. However, the obligor (account debtor) has the right to invoke the anti-assignment clause against the assignee only when the assignee has knowledge of the clause or acts with gross negligence at the time of assignment. Moreover, this problem is compounded
because the new law expands the scope of set-off that an assignor’s counterparty (the obligor on a receivable) might exercise in the case of a breach of contract.41

Apart from the private law governing secured transactions in personal property, another important and relevant legal framework is the government-supported guarantee program for prefectural credit guarantee corporations (CGCs).42 Much of the credit risk of the CGC guarantees is transferred to the Japan Finance Corporation (JFC) through various insurance products that JFC provides.43 JFC also extends direct loans to SMEs.44 About one-third of the SMEs operating in Japan have bank loans guaranteed by CGCs or JFC financing.45 Historically these guarantees covered 100% of the supported loans but since 2018 the maximum coverage has been 80%.

Finally, the regulatory treatment of collateral for Japanese banks is relevant as it has been a constraining influence on the use of ABL.46 Under the Inspection Manual of the Financial Services Agency (FSA), in effect until December 2019, collateral was classified as “good collateral” (such as deposits and government bonds) or “general collateral” (primarily, immovables).47 With the goal of promoting the use of ABL, the FSA revised the Manual in 2007 to provide that movables and receivables could be classified as general collateral.

Classification as general collateral would entitle the bank to capital relief under risk-weighted capital requirements. However, the requirements under the revised Manual for classifying movables as general collateral were quite burdensome, even after clarifications of the requirements by the FSA in 2013.48 Ultimately, the entire Manual was abolished effective December 18, 2019,49 primarily because banks tended to adhere quite rigidly to its guidelines, which was thought to impair banks’ flexibility in dealing with their customers.50 Additional flexibility might extend beyond allowances for loan

41 Hara, supra note 8, at 187.
42 For a recent and comprehensive treatment of CGC guarantees in Japan, which provides a thorough and critical assessment, see Marek Dubovec and Shogo Owada, Secured Lending Stimulants: The Focus on Public Credit Guarantees, 16 U. Pa. Asian L.Rev. (forthcoming 2021).
44 Id.
45 Id.
46 See generally Hara, supra note 8, at 195; infra Part III.B.5.b..
48 For example, the Manual imposed conditions including (i) the method of perfection (interpreted to require registration), valuation of collateral (interpreted as requiring an external evaluator), monitoring, measures for disposition of collateral (interpreted as requiring a secondary market), and procedures for enforcement. See Hara, supra note 8, at 195.
49 See FSA, JFSA’s Supervisory Approaches, Replacing Checklists with Engagement (January 2018), https://www.fsa.go.jp/en/wp/supervisory_approaches.pdf. Abolishing the Inspection Manual was part of the FSA’s new approach of “[s]hift[ing] from rule-based compliance checks to balanced use of rules and principles.” Id. at 3. The new approach emphasizes “the role of substantive, forward-looking and holistic analysis and judgment” in contrast to the FSA’s earlier emphasis on compliance with “minimum standards prescribed in the Agency’s checklists.” Id. at 34.
and lease losses to include more flexibility in ABL collateral valuation. It is unclear whether abolishing the manual has resulted in increased flexibility in fact, however, and the FSA has issued no further formal guidance on ABL collateral valuation. We understand that in general the manual was not strictly enforced during the last few years that it was in effect. It seems that the accountants recognize that each bank may continue the policies it followed prior to the abolishment of the manual, at least for accounting purposes.51

III. KEY FINDINGS

Our interviews have provided information about a wide range of financing practices. They reflect the views, attitudes, and opinions of bankers and other professionals on many subjects. This Part summarizes key ABL-related findings from the interviews, as supplemented by our subsequent informal consultations. We focus here on the principal questions that motivated our study: For example: Why is the use of ABL in Japan so limited?52 What are the principal obstacles and disincentives to the use of ABL in Japan? Are there law reforms that would facilitate the use of ABL and, if so, what are they? We offer two prefatory observations about the following discussion. First, it is impossible to draw firm conclusions about causes and effects. For example, some factors that plausibly account for the limited role of ABL might just as well be characterized as effects that result from the limited use of ABL. Second, we do not shy away from offering our considered hypotheses about ABL in Japan. But we admonish readers that our views range from those firmly grounded in fact to those more properly characterized as thoughtful conjecture. Finally, our research illuminates the stark contrast between the situation in Japan and the modern principles of secured transactions law embodied in the UNCITRAL Model Law on Secured Transactions, which is designed to enhance access to credit through ABL.

We first discuss the general approaches taken toward taking collateral for bank loans. This discussion includes some examples of experiences of banks with ABL and in some respects the lack of experiences. We then consider various impediments to the use of ABL in Japan. Our discussion of these factors proceeds, however, in no particular order of significance. Moreover, any attempt to offer such a ranking of various obstacles to ABL would be futile in view of the interrelationships among these factors and, as already mentioned, the difficulty in drawing causal connections.

A. Collateral for Loans: Practices, Attitudes, and Experiences

Our interviews revealed a variety of practices and preferences in connection with the use of PRAMC registration and the methods of third-party effectiveness available

52 See Hara, supra note 8, at 174, noting that loans involving “the use of account receivables and inventories as collateral are between 0.2 per cent and 0.1 percent, to 3.3 per cent and 0.9 per cent, respectively”, of the loans made to companies (citing Arito Ono, et al., A New Look at Bank-Firm Relationships and the Use of Collateral in Japan: Evidence from Teikoku Databank Data, in TSUTOMU WATANABE, ICHIRO UESUGI & ARITO ONO (EDS.), THE ECONOMICS OF INTERFIRM NETWORKS (2015).
under the Minpō (generally fictitious delivery of movables and notification to obligors on claims). For the most part the interviews did not reveal any consistent patterns. Indeed, one bank indicated that the perfection methods to be used were left entirely to the discretion of individual branches in consultation with the borrowers.

Some banks prefer to use a fictitious delivery instead of PRAMC registration for assignments of movables, sometimes in conjunction with the physical attachment of a “sticker” to the movables evidencing the assignment and constructive delivery to the assignee. Other banks regularly use registration for movables even if they typically use notification to obligors for assignments of claims. However, registration for assignments of claims sometimes is favored in order to reduce the potential stigma or reputational costs for borrowers or to avoid any inconvenience for a borrower’s important customers (obligors on claims).

Registration is a typical and useful method of perfection in the case of assignments of multiple claims owed by many obligors to a single assignor (as in securitizations). In transactions involving a large number of assigned claims, however, banks may require assistance by an accountant in order to monitor the existence and update the status of the claims. When there is a single obligor or a small number of obligors, such as with an electric power company in the case of a project financing for wind or solar energy, notification of (or acknowledgement by) the obligors is more common. In those transactions good practice may also involve obtaining a consent from the obligor and the obligor’s agreement to pay the assignee. Moreover, that is necessarily the case in the setting of so-called “bulk” or “reverse” factoring transactions. In these arrangements an obligor with large numbers of payables (such as a large manufacturer of automobiles or other high-value equipment) arranges a financing program for its suppliers. Qualifying suppliers have assurances ex ante that the designated financer (or participating financers) will make advances against the suppliers’ receivables from the obligor. In these transactions registration would be cumbersome as it would involve a separate process for registration of an assignment by each assignor (supplier). This is essentially a technological and programmatic problem, rather than a legal one. It could be addressed by a more user-friendly method of effecting registrations of assignments by a large number of assignors with claims against a single obligor.

Bankers generally agreed that ABL can be very useful for borrowers with weak credit, including those in financial distress. It sometimes may be a last resort for such borrowers to obtain credit. A lender has considerable leverage with a financially distressed borrower in an ABL transaction (as well as with immovable collateral) inasmuch as the borrower may reasonably fear the loss of its assets in case of default. (On the other hand, in a default context banks generally are reluctant to resort to

---

53 See infra subpart B.6. (discussing stigma and reputation issues).
54 In a typical factoring context, in contrast, it is a single holder of many receivables from multiple obligors that arranges to assign its receivables to an assignee (factor).
55 Of course, each assignment must be separately indexed under the name of each assignor consistent with structure of the PRAMC registry. But the suggestion in the text contemplates a single document or communication to the registry that would combine, list, and describe on a single schedule each assignor and assignment.
enforcement against collateral, preferring other approaches such as rescheduling payments). One bank offered a similar example of leverage achieved by taking “side collateral,” on which the bank does not rely on the collateral for its value as such but as a means of discouraging other lenders from doing business with the borrower (described as “protecting our clients” from other financial institutions).

Notwithstanding the relatively limited use of ABL, there are transactions in which loans are made on the basis of valuations of movables (such as inventory) and security interests are registered under PRAMC. For example, non-bank lenders sometimes make loans primarily on the basis of asset values to weak borrowers or businesses with little business history, such as a start-up or venture business without immovable property. In some of these cases asset values may actually exceed going business values. While some loans to weak borrowers might not be made without an ABL structure, the costs and other impediments relating to ABL mean that in some cases loans simply cannot be made even with collateral.

One frequently mentioned advantage of ABL is that it facilitates a bank’s ability to monitor a borrower’s business activities. However, experienced ABL professionals explained that monitoring is just as easily available in unsecured lending arrangements through reporting and monitoring covenants. One alternative to ABL (described by one banker as “increasingly popular”) is aggressive monitoring of assets (such as comparisons of actual inventory with inventory on financial statements) without actually taking a security interest (sometimes referred to as “asset-based financing” or “ABF”). That approach would yield the functional benefits of collateral assuming no other material creditors are in the picture. On the other hand, another professional explained that the process of monitoring collateral and the accompanying regular borrower interactions provide valuable experience for bankers and also builds relationships between borrowers and bank lenders.

One banker offered the following summary of ABL use in recent years: After the expansion of PRAMC to cover not only assignments claims but also of movables, several financial institutions expanded their use of ABL. These included some major city banks as well as regional banks. ABL was used in particular with start-up firms, but with mixed results. After the Lehman failure and the 2008-09 financial crisis, ABL transactions increased in particular for financially distressed borrowers that were downsizing. As the financial climate improved many surviving businesses retired or refinanced ABL transactions and ABL transactions declined.

Several bankers explained that solar power financing became very popular following the March 2011 earthquake. Some loans were secured only by equipment. Most, however, were structured as “project financings” supported primarily or solely by the collateral assignment of receivables from power company purchasers of solar-generated power and with the “project” rather than the operator/borrower as the primary focus. These assignments of receivables were often (but not always) perfected by
notification to obligors instead of registration. Due to substantially lower pricing and less government support, solar and wind project financing are less popular now.\(^{56}\)

Several bankers expressed a favorable attitude toward reforming Japan’s secured transactions law and others indicated at least an open mind on the issue. That said, it is clear from our interviews that bankers in general do not promote or encourage ABL for their borrowers. This attitude is consistent with the various obstacles to the use of ABL addressed next.

B. Causes and Effects of Limited Use of ABL\(^ {57}\)

1. Perception that Benefits of ABL Are Limited: Low Interest Rates, Low Default Rates, General Availability of Credit

Many of the bankers’ observations about ABL focused on the difficulties and costs associated with obtaining effective security rights over movables and claims, as discussed below. But most of them explicitly or implicitly also acknowledged the limited benefits that they perceived to be achieved from obtaining movables and claims as security for loans under current conditions. For example, the very low-interest rate environment necessarily constrains the potential for collateral to lower the cost of credit. However, some also recognized that in a future higher-interest rate environment the ABL model might be more attractive. Most also perceived that business credit is readily available in Japan, which also serves to reduce the benefits of collateral.\(^ {58}\) The relatively low incidence of default and enforcement in Japan further lowers their perception of the benefits of security. These views notwithstanding, it is interesting that the use of immovables (when available) for securing loans remains quite common and popular.\(^ {59}\)

2. Reliance on Immovables Collateral

When collateral is required as a condition for lending bankers expressed a strong preference for immovables collateral over ABL. This preference results from a variety of factors. Historical practices favoring immovables security might be the most significant. In addition, regulatory benefits and costs are significant considerations because immovables collateral has the status of general collateral for regulatory purposes. Related to this, bankers expressed confidence in their in-house valuations of immovables, in sharp contrast with their views on valuation of movables.\(^ {60}\) Apparently many banks have employees who are licensed as real estate appraisers and have considerable


\(^{57}\) See generally Hara, supra note 8, at 193-95 (discussing obstacles to the use of ABL in Japan).

\(^{58}\) See id. (explaining that Japan is a “borrower’s market” for SMEs, in part due to government policies that favor such credit and discourage enforcement and default).

\(^{59}\) See infra subpart B.2.

\(^{60}\) See infra subparts B.4.b., B.7.
experience in valuation of immovables. No licensing system exists for appraisal of movables and in general staff members of banks lacked experience in the valuation of movables. Several bankers also explained that reliable market data is available for immovables but comparable data is not available for movables.

3. CGC Guarantees

Many if not most of the bankers we interviewed acknowledged that their institutions would prefer making a loan with a CGC guarantee over using ABL, in many cases for reasons of cost and administrative burdens. Consistent with those sentiments, there is little doubt that the availability of CGC guarantees generally reduces the appetite of bank lenders for personal property collateral. Given the goal of the CGC program to support SMEs, the credit policies and standards of the CGCs are likely to be less stringent than the policies of the banks whose loans are guaranteed. CGC guarantees are most useful (and used most by some banks) for loans to distressed borrowers or borrowers with a short business history. Of course, these are also the borrowers as to which ABL might be most suitable, which highlights that there typically may be a choice between a CGC guarantee and ABL. Moreover, not only does the availability of CGC guarantees discourage the use of ABL but it also reduces the incentives for law reforms that could facilitate the use and reduce the cost of ABL.

Bankers noted that in recent years there has been a trend to reduce reliance on CGC guarantees, in part because of pressure from the FSA. The principal concern about these guaranties is the moral hazard problem—they reduce incentives for banks to exercise prudent credit analyses and assessment of borrowers. The FSA position is understood to mean that reliance on the guaranties should not be avoided altogether, but also should not be to the exclusion of understanding the businesses and creditworthiness

---

62 See infra subpart B.4.
64 Mooney, supra note 7, at 37.
of borrowers. Responses to the current recession arising out of the pandemic appear to be exacerbating the moral hazard problem.

In a 2016 Report the Financial Working Group (FWG) proposed reforms to the CGC system. A principal objective of the Report was for the CGCs, through the guarantee program, to encourage financial institutions to provide business financing to SMEs based on assessments of an SME’s business and without excessive reliance on guarantees. In particular, the Report emphasized the need for financial institutions to support SMEs by providing “follow-up management and business support during the financing period, resolving problems while communicating with enterprise operators, and promoting the development of business.” It is unfortunate that neither the Report nor the law reforms based on its recommendations focused on promoting and providing incentives to financial institutions to finance SMEs through ABL as a means of reducing reliance on CGC guarantees.

Cost also is a factor for banks and borrowers in considering whether to enter into a loan transaction covered by a CGC guarantee. When the CGC guarantee fee is added to

---

65 Although this discussion focuses on CGC guarantees in particular, the FSA has also encouraged banks not to rely on immovables collateral and guarantees generally (including personal guarantees from business owners in accordance with its guidelines). It has emphasized the importance of having a good understanding of a borrower’s business and communications with borrowers. See FSA, GUIDELINE ON PERSONAL GUARANTEE FROM BUSINESS OWNERS (2014), https://www.fsa.go.jp/policy/hoshou_jirei/index.html (FSA GUIDELINE).

66 For example, in 2020 the number of CGC supported loans was approximately four times the number in 2019 (no doubt influenced by the pandemic). Japan Federation of Credit Guarantee Corporations provides on its website the relevant data on CGC supported loans, summed up for all of the 51 CGCs in Japan, https://www.zenshinforen.or.jp/document/hosho_jisseki.pdf; see also Taiga Uranaka et al., Bank of Japan’s Covid Loan Programs Risk Revival of Zombie Firm Concerns, BLOOMBERG (Sept 8, 2020) (business loan programs run risk of creating more “zombie” companies).


68 The FWG Report, supra note 67; Yamori, supra note 68, at 4.

69 FWG Report, supra note 67; Yamori, supra note 68, at 4.

70 FWG Report, supra note 67.

71 Act on the Partial Revision of the Small and Medium-sized Enterprise Credit Insurance Act to Promote Improvements and Developments of Business of SME’s Business Management, Law No. 56 of 2017, art. 20-2 (enforced on April 1, 2020); see Yamori, supra note 68, at 2.

72 Although the Report did not consider ABL, the FSA Guideline proposes that financial institutions consider ABL as an alternative to the use of personal guarantees of business owners. See FSA GUIDELINE, supra note 65. See also WBG, supra note 63, at 41: [Public guarantee systems] that require banks to take a security interest in some collateral and do not provide full coverage against losses provide an incentive to develop expertise in secured lending, including to assess and monitor credit risks. Moral hazard is reduced if the borrowers share the risk by putting up some assets as collateral for a loan.
the otherwise prevailing low interest rates it materially increases the borrower’s effective cost of borrowing and leaves little room for a bank’s spread (profit). Nonetheless, CGC guarantees are a significant factor in facilitating extensions of credit to SMEs in Japan. Although some loans with CGC guarantees are also secured by claims and inventory, these represent a very small percentage of the guaranteed loans.  

4. Costs of ABL

Virtually all of the bankers noted that costs of ABL are a negative factor that discourages its use. In many transactions ABL simply is not feasible because borrowers are reluctant or unwilling to absorb these costs. The result is that in many cases competitive concerns prevent the banks from requiring and obtaining personal property collateral. This concern is exacerbated in the current very low-interest rate environment. For small loans the costs of ABL could amount to a substantial portion of overall cost of borrowing. For example, one banker indicated that in larger loans of JPY 10 Billion or larger the ABL associated costs are manageable. But for smaller loans the costs make ABL impractical.

It is anomalous, perhaps, that credit enhancement through the use of either CGC guarantees or ABL increases a borrower’s overall costs of borrowing even if a borrower’s interest rate would be higher if the neither approach is employed. On the other hand, there are some loans that would not be made, even with a higher interest rate, in the absence of a guarantee or ABL.

a. Shihō Shoshi

Bankers generally expressed concerns about the legal costs of using ABL. A significant legal cost that was mentioned arises from the need to have shihō shoshi involved in the process. Largely due to the difficulties involved with ensuring that the descriptions of assigned movables and claims are sufficient for a valid registration (especially with respect to future-acquired inventory and future receivables) assignees normally must rely on the involvement of shihō shoshi. Even so, in practice the shihō shoshi who undertake registrations often must consult with the PRAMC registry officials to ensure the adequacy of the property descriptions. One partner of a large law firm observed that the firm generally would not assume responsibility for a description of future receivables in a PRAMC registration but would refer that duty to a shihō shoshi. Moreover, the availability outside of the Tokyo area of shihō shoshi with substantial experience with ABL is quite limited.

73 If providing such collateral were to become a normal requirement for obtaining a CGC guarantee that would, in our view, result in significantly enhanced capacity building within the Japanese banking community. See subpart B.10 (discussing capacity building); WBG, supra note 63, at 41 (quoted at note 72. However, this could be problematic when a borrower has loans outstanding with more than one bank, especially if there are multiple CGC guarantees. That situation might require a collateral sharing arrangement among the several lenders.

74 Cost concerns derive in large part from the legal infrastructure for ABL discussed infra subpart B.5.

75 See supra Part II; infra subpart 5.a. (discussing registration requirements).
b. Valuation of Collateral

None of the bankers indicated that their banks had the internal capacity to value movables, unlike the situation for immovable property. When valuation of movables is needed in order to qualify movables as general collateral for regulatory purposes, the additional cost of retaining a third-party valuation firm is necessary. This is problematic as well because there are few valuation companies in Japan. The absence of in-house expertise and experience in valuing movables is not only a cause of diminished use of ABL in Japan but it is a result of the low utilization as well. Were ABL more widely used it is likely that over time the internal valuation capabilities of bank staff would increase. Bank policies that require bankers to rotate among different departments also contributes to bankers’ lack of expertise and experience with ABL, including valuation of movables.76 This dearth of in-house expertise reflects a need for capacity building in order to maximize the benefits available under the existing legal regime.77

c. Administrative Costs and Burdens

Several bankers observed that ABL involves a variety of administrative costs. These include costs and burdens of monitoring collateral, requiring and reviewing reports on collateral, assessing whether and to what extent personal property collateral is sufficient, and dealing with PRAMC registrations (including the costs of registrations). Monitoring costs have been driven in large part by banks’ efforts to qualify movables as general collateral for regulatory purposes. Some banks choose to notify obligors on claims or to use fictitious deliveries of movables in order to avoid the costs of registration. The complexity of dealing with ABL also gives rise to administrative burdens of dealing with the process of internal bank credit approvals as well as explaining to borrowers the details of collateral arrangements. Some bankers outside of the Tokyo area also observed that troublesome delays in making and confirming registrations sometimes result from the location of the PRAMC registration office in Nakano (Tokyo).

5. Issues Related to Legal Infrastructure

a. Private law of Secured Transactions

Reference already has been made to the costs associated with ABL, including costs associated with the registration of assignments under PRAMC. In many cases banks find it necessary to retain a shihō shoshi in connection with ABL, especially when a registration is to be made. In particular, the legal requirements for descriptions of movables and claims that are sufficient to identify the collateral (and especially future-
acquired collateral) are not amenable to the use of simple, standardized forms. The complexity of the registration requirements and the resulting risks of errors is necessarily problematic. An error on the registration can result in loss of priority to a third party or in an insolvency proceeding or at best in a negotiated settlement of the dispute. For example, one bank that had experienced an error in its registration lamented that PRAMC registrations are not checked by the registration office, which distinguishes them from registrations for immovables. The 10-year limited duration of a registration of an assignment of movables and of claims (when all of the obligors are not identified on the registration) also was criticized.

The exclusion of individual assignors from the PRAMC registration regime is problematic as well. For these individual borrowers it is necessary to utilize the Minpō methods of transfer—primarily fictitious delivery of movables or notification to obligors on assigned claims. Several banks with many individual borrowers mentioned this problem.

Aside from issues related to registrations, some bankers noted other uncertainties and risks under the applicable law. For example, some mentioned the unavoidable risk that earlier “secret” assignments made effective under the Minpō have been made that would have priority over a later-in-time assignment (whether made effective by registration or a Minpō method). As explained above, a search of the PRAMC registry will not reveal earlier unregistered assignments that might have priority over a prospective creditor. Others noted the lack of clarity on the status of “junior” interests in the context of jōto tanpo and the inability to enforce junior interests even if they are recognized.

Many of the bankers noted that they and their banks had little if any experience with priority conflicts for collateral, suggesting that this has not presented a serious practical problem. One banker was of the view that assignments of fictitious, non-existent claims pose a greater risk than conflicting, double assignments. But priority conflicts, even though infrequent, do occur. For example, one banker described a situation in which the bank’s inventory collateral was subordinate to an earlier assignment made to a governmental entity whose interest was perfected by a fictitious delivery. In that case another bank also had a security interest in the inventory and each bank had registered its interest with a description identifying the location of the movables. This banker noted that the need to identify collateral by location in a registration was problematic because a borrower may move inventory from one location to another (perhaps for legitimate business reasons and not necessarily with any fraudulent intent).

---

78 See infra Part II (identification requirements under ordinances pursuant to PRAMC Arts 7(2)(v) and 8(2)(iv)).
79 We note however, that there is a system for prior consultation with the PRAMC registrar, which does not exist for immovables. See Hara, supra note 8, at 190.
80 See PRAMC arts. 7(3), 8(3)(ii).
81 See supra Part II (discussing unpublicized assignments and priority).
Another banker pointed to an example in which the bank registered assignments of claims and later discovered that some claims covered by the registered assignment had already been assigned to a factoring company. Although the registration covered a large number of future claims (and did not describe each assigned claims specifically), in order to avoid any conflict the bank thought it necessary to re-register the assignment so as to exclude the previously assigned claims. Neither PRAMC nor the associated ordinances contain provisions that affirmatively and generally address the amendment of the terms of a registered assignment, with limited exceptions. Although the bank generally undertakes due diligence in connection with such assignments, the condition of the records of some SMEs may lead to such conflicts.

Several bankers indicated their awareness of past and ongoing discussions of law reforms relating to priority, including the possibility of awarding priority to registered assignments over those perfected under Mimpō methods. Some expressed support for such a first-to-register priority rule. Another banker was critical of the doctrine of crystallization—the identification of the assets (such as inventory) that are the subject of enforcement of a jōto tanpo security interest. In particular this banker took issue with the unavailability of collateral acquired after crystallization, which means that it is not possible to determine in advance the collateral that would be available upon a future default and enforcement.

b. Regulatory Treatment of ABL

The difficulty and expense of complying with the FSA’s conditions for the treatment of movables as general collateral, as described above, has further constrained and discouraged the use of ABL by banks. Arguably the abolition of the FSA’s Inspection Manual may offer banks more flexibility in the treatment of movable as general collateral.

Another problem that might be classified as “regulatory” relates to government programs related to nursing care receivables. For example, the structure of one such program may impair the financing of receivables of certain nursing care providers because the providers act as collection agents for patients but are not themselves the proper owner-assignors of the rights to payment under the program.

6. Stigma, Reputation, and Borrower Attitudes

Many bankers observed that borrowers and lenders typically associate the use of ABL with a borrower’s poor financial condition and lack creditworthiness. ABL is often...

---

83 See supra subpart B.4., infra subpart B.7. (discussing costs of ABL and existence of a secondary market); see generally supra Part II.
84 See Hara, supra note 8, at 195.
85 See infra subpart B.8.
seen as a borrowers last resort for obtaining credit. This ABL-associated stigma and reputational risk accounts for substantial borrower resistance to ABL transactions. This is yet another example of the interrelationship of causes and effects relating to ABL. Although the stigma discourages the use of ABL it also results in part from the lack of use of ABL in ordinary course, routine lending transactions, in particular for SMEs. Greater use of ABL, especially if it were to become a “normal” and “common” term of lending, could substantially reduce this stigma.

Some banks recognized that the use of PRAMC registration of assignments reduces the reputational risk inasmuch as registration is a “silent” system that results in less notoriety than a notifying an obligor. This attribute is ironic, to say the least, for a system ostensibly designed to provide public notice of assignments. It also suggests that the concerns may primarily relate to a borrower’s reputation among the members of its relevant business community (which would include obligors on claims). Consistent with this observation, some banks that register assignments delay in their notifications to obligors (so as to trigger the obligor’s obligation to the assignee) in order to avoid the stigma that an obligor might associate with an assignment.

Aside from the concerns about stigma and reputation, some bankers mentioned borrower resistance to ABL based on concerns about the loss of control over the business. One banker also noted that borrowers have raised objections to the “absurd” ability of an assignee of a receivable to access the full amount of the receivable without any reduction to account for a borrower’s costs of earning the receivable. This complaint (which is itself absurd) is without merit; it fails to appreciate that the borrower already has received secured loans and that the lender’s collections cannot exceed the amount of loans plus interest and other fees and costs. But it exemplifies the sort of misperceptions that burden some unsophisticated borrowers.

7. Lack of Secondary Market for Movables

Several bankers mentioned that the lack of a deep secondary market for many types of movables reduces the benefits of ABL. Obviously, uncertainty as to the prospects for recovering value from collateral upon a borrower’s default inhibits ex ante reliance by lenders. There are “jobbers” who specialize in buying movables (inventory, in particular) from distressed firms and firms in bankruptcy, but they typically buy at a very low price (such as 10% of the retail price). Again, the cause-effect aspects of the thin secondary market are muddled. Clearly the thin market reduces the prospects for reasonably predicting and relying on recoveries from movables collateral, thereby discouraging the use of ABL. On the other hand, greater use of ABL for movables would

---

86 On the other hand, some banks also recognized that registration does not eliminate the stigma/reputational risks. Moreover, even without a formal search of the PRAMC registry registered assignments are easily searchable by the general public under the name of an assignor in the Teikoku databank. See supra Part II (discussing PRAMC registration).
likely enhance the development of secondary markets. Of course, the thin market also directly exacerbates the related challenges of ex ante valuation of movables.

8. Non-Assignability: Anti-Assignment Clauses and Other Restrictions

Several bankers cited anti-assignment clauses as imposing another impediment to the use of receivables as collateral. Some bankers also expressed optimism for future reductions in the impact of anti-assignment clauses based on the recent legislation. As already discussed, the new legislation is useful but it is not a complete solution.

One banker emphasized the benefits of a workaround employing a self-settled trust that has been used to overcome the effects of anti-assignment clauses, in particular for assignments of receivables in securitization transactions. However, this technique might not be practical for transactions that would not support the additional costs of implementing the trust structure. To implement this structure an assignor (such as a borrower or an originator in a securitization), as settlor, declares a trust and transfers the receivables to itself, as trustee, for the benefit of itself (the assignor), as trust beneficiary. The assignor-beneficiary then assigns (jōto tanpo) its beneficial interest in the trust assets (i.e., the receivables) to a lender as security (or in an outright sale transaction to the relevant entity in connection with a securitization). In this structure the initial transfer to the trust is understood not to violate any anti-assignment clause because the original legal owner of the receivables remains the beneficial owner as trust beneficiary. The transfer to the ultimate assignee after the trust has been created is understood not to violate the restriction because it is the beneficial interest in the trust assets (the receivables), not the receivables, that is transferred. However, this structure has not been tested in the courts as an effective means to overcome an anti-assignment clause.

Noncontractual obstacles to assignments of receivables also can impair the use of rights to payment as collateral. For example, the Osaka High Court has held that an attempted assignment of rights to payment by a provider of nursing care services was not

---

87 Note a recent advertisement of an “asset management” firm in the United States:

We are a nationwide asset monetization group. We specialize in dealing with persons that are in bankruptcy or pre-bankruptcy. We provide asset liquidation services in regards to equipment, merchandise and real estate. We can maximize recovery, and obtain fair market value for any, and all assets. Please feel free to reach out to learn more about how we can help you and your clients.

There is no obligation, and consultation is free.

88 See infra subpart B.4.b. (discussing valuation).

89 See supra Part II (discussing anti-assignment clauses).

90 For discussions of this technique see Akio Yamanome, Masaya Miyama, & Satoshi Inoue, Saiken Jōto Seigen Tokuyaku, 1522 JURISTO 63 (2014); Masayuki Fukuda & Yoshimune Muraji, Jikoshintaku wo riyōshita Jōto-kinshi-tokuyaku-tsuki saiken to no Shōkenka/ Ryūdoka no Jitsumu to Hōtekikadai, 8 SFJ Journal 10 (2014). Although some banks may utilize this technique in connection with securitization of claims, we understand that banks generally encourage debtors to negotiate with their creditor for approval of the assignments of claims.
The court reasoned that the receivables were owed not to the provider-assignor but to the individual recipient of the services pursuant to the Long-Term Care Insurance Act. Although some banks continue to finance these receivables, the object lesson here is that government programs that would facilitate—not impede—financing by transaction parties would further the underlying goals of the programs.

9. **Enforcement Challenges (including Limited Use of Insolvency Proceedings)**

Bankers expressed several concerns relating to the enforcement of security interests following a borrower’s default. One worry was that upon a borrower’s default the collateral might not be available. Another was that the value of collateral on hand may have declined. For example, there is a perception that a failing borrower is likely to address a liquidity problem by selling assets, with the result that few assets might be left for a secured lender. As one banker explained, a financially distressed borrower’s inventory may be very different than at the time when the loan was made. Also, enforcement as to movables probably would recover only a small percentage of the original value (one example given was 10%). Under these assumptions’ borrowers would be discouraged from agreeing to provide collateral if it would support financing of only such a small percentage of the collateral value. We note, however, that this view is apparently based on the dubious assumption that the amount loaned would be based primarily on the liquidation value of collateral.

Enforcement and collection of assigned claims is particularly problematic when future claims have been assigned. Information necessary to collect on these claims (such as the details of the claim and the identity and contact information of the obligor) may not be available to the assignee bank. More generally, direct collection from obligors is problematic when advance notice to an obligor is not made. In such cases obligors may question whether an assignment has actually been made. A better practice sometimes followed is to work cooperatively with the borrower (assignor) in collecting on the claims.

Although not explicitly mentioned by our interviewees, we speculate that at least some of the pessimism about enforcement may be exacerbated by the extremely low use

---

91 Osaka Kōtō Saibansho [Osaka High Ct.] Sep. 8, 2015, Hei 27 (gyoko) no. 89, 2034 JUNKAN KIN’YŪ HOMU JUO [KIN’YŪ HOMU] 78. Many providers have few assets to provide as collateral other than the prospect of obtaining payment from these receivables.

92 See Long-term Care Insurance Act, Law No. 123 of 1997, art. 41(1) (the municipality shall pay allowance for the service to the insured person), (6), (7) (payment should be made to a service provider on behalf of insured person), [Link](http://www.japaneselawtranslation.go.jp/law/detail/?id=94&vm=). Compare the Health Insurance Act, Law No. 70 of 1922, which provides for a medical insurance system with similar underlying policies to the long-term care system. However, the Health Insurance Act provides that payments for medical treatment expenses are to be made to the providers of medical services. *Id.*, art. 76. [Link](http://www.japaneselawtranslation.go.jp/law/detail/?id=3266).

93 These concerns are examples of the need for capacity building in connection with collections of receivables collateral. See *infra* subpart B.10 (discussing capacity building).
of formal insolvency proceedings by financially distressed businesses in Japan. By way of contrast, secured creditors in the US can be relatively confident that a distressed debtor in default (or facing imminent default) on outstanding secured obligations to a bank or finance company will file for protection under Chapter 11 of the US Bankruptcy Code. The principal exception to this scenario would be a debtor that is working cooperatively with its creditors. In either situation the risk of a debtor absconding or hiding assets is relatively slim.

Most interviewees had only limited experience with enforcing security interests in actual insolvency proceedings. This is consistent with the low use of insolvency proceedings in Japan, mentioned above. It also is consistent with the relatively limited use and experience more generally with ABL, including enforcement.

The experiences with ABL in insolvency cases that were reported in our interviews were mixed—some positive and some negative. For example, under the Corporate Reorganization Law access to collateral would be limited and crystallization would be an issue. On the other hand, the Civil Rehabilitation Law offers flexibility to negotiate with the debtor concerning security interests and this ameliorates the concerns about crystallization. There are advantages when a distressed borrower liquidates through a formal insolvency proceeding. For example, a lender and a bankruptcy trustee may cooperate in the collection of assigned receivables, with the trustee and the lender sharing in the collections. Similarly, it may be advantageous for a lender and a trustee to cooperate in the sale of movables collateral.

Experiences with default and enforcement (including in connection with insolvency proceedings) reflect the difficulty of determining causes and effects. The limited use of ABL results in correspondingly limited experience with default and enforcement. This lack of experience, in turn, presumably is a factor in discouraging the use of ABL.

10. Need for Capacity Building

In our view the interviews strongly support the conclusion that the use of ABL would be encouraged and the benefits of ABL would be increased by stimulating capacity building among financial institutions, borrowers, and the advisors to each sector. Formal initiatives such as enhanced training and the addition of experienced staff would

94 During the fourth quarter 2019 and first quarter 2020 the number of court filings of business insolvency proceedings in Japan (an average of 729 filings per month) were about 9.5% of the number of filings in the United States (an average of 7,649 per month). Japan Bankruptcies, TRADING ECONOMICS, https://tradingeconomics.com/japan/bankruptcies; United States Bankruptcies, TRADING ECONOMICS, https://tradingeconomics.com/united-states/bankruptcies. Compare the relative size of each country’s GDP for 2019, which (in trillions of US $) was $21.374 for the United States and $5.081 for Japan (about 23.8% of the United States GDP). World Bank Group, https://data.worldbank.org/indicator/NY.GDP.MKTP.CD. See also infra Part V (discussing the need to balance secured transactions law reforms with insolvency laws in the interest of the goal of rehabilitation and to adjust insolvency law to respect and protect holders of security interests).

95 See infra Part II (discussing crystallization).
be welcome and useful. But the most effective capacity building is likely to result only from substantially greater experience with ABL, and such advances in experience and skill development are unlikely to be robust so long as ABL transactions are so limited in number and significance. This highlights, once more, the complex relationships between causes and effects in this context. Increasing the use of ABL, whether by way of capacity building, law reforms, or other means, may require targeted governmental encouragement.

IV. SECURED TRANSACTIONS LAW REFORM IN JAPAN: ASSESSMENT AND TENTATIVE PROPOSALS

This Part summarizes our tentative proposals for secured transactions law reforms in Japan based on assessments of our interviews and other research to date. We do not offer these as “optimal” solutions. For example, all things being equal we would be inclined to support adoption of comprehensive reforms that would substantially embrace the emerging modern principles of secured transactions law, as reflected by instruments such as the UNCITRAL Model Law on secured transactions and its predecessor UNCITRAL texts. But all things are not equal. Instead, we have given great weight here to our practical assessment as to the changes in law that might plausibly be adopted in Japan in the near to medium term.

We focus here on law reforms that we believe would reflect sound public policy. We do not dwell on interpretive issues or the proper resolution of doctrinal questions that are controversial under current law. That current law may reflect a sound application of prevailing legal doctrine is beside the point. The project here is to identify areas where current law should be modified to implement policies that would better promote social welfare. We offer these proposals as a point of departure for further discussion. But limitations of time and space limitations dictate that a thorough analysis of the merits of our proposed revisions is beyond the scope of this paper.

In subpart A we outline the proposed law reforms that we believe are the most significant. In general, our proposals seek to adopt some of the most important features of the modern principles of secured transactions law while minimizing disruption of current Japanese law and with adjustments as may be needed to make adoption in Japan plausible. Following that discussion, in subpart B we consider how these proposed law reforms might favorably impact Japan’s ranking in the annual Doing Business study by

---

96 UNCITRAL, supra note 7; Mooney, supra note 7, at 28-29.
97 For example, our proposals contemplate retention of the basic attributes of PRAMC, including its applicability only to title transfers such as jōto tanpo. That said, we would of course support adoption of changes such as a modern secured transactions registry that is not limited to title transfer security and to the codification of principles that would supplant the judicially-created jōto tanpo device.
the World Bank Group (WBG). In that subpart we also identify some additional law revisions (which we also support) that could further improve Japan’s ranking.

The WBG ranking on “getting credit” is particularly relevant here. While Japan ranks 29th overall in the 2020 survey, it ranks 94th out of 190 surveyed countries in the getting credit category. Secured transactions-related laws impact in particular the “strength of legal rights index” (SLR index) which “measures the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders and thus facilitate lending.” On the SLR index Japan scores only 5 positive responses out of a possible 12. We hasten to add that we recognize that the WBG study, as a meaningful and accurate assessment of access to credit in any country, including Japan, is seriously flawed in many respects. That said, however, improving Japan’s ranking nonetheless might be offer benefits.

A. Principal Proposed Reforms

1. First-to-Register Priority Rule

An important step toward a modern secured transactions registry in Japan would be the adoption of a first-to-register priority rule. As explained above, earlier-in-time assignments of movables or claims made effective under the Minpō will have priority over any later assignment. This obviously reduces the utility of the PRAMC registration system—a search of the registry will not turn up earlier “secret” assignments. This revision would address criticisms of the current priority rule mentioned by several bankers in our interviews. Revising the priority rule to provide that the first-registered assignment has priority would resolve this problem.

It is important to understand that a coherent first-to-register priority rule would award priority even if the first registered assignment was not the first actually to occur.

---


99 We do not suggest that the reforms discussed in this Part are the only ones that should be seriously considered. For example, we discussed above a potential modification of the PRAMC registration procedures that would simplify the registration of multiple assignments of receivables by many assignors involving a single obligor. See text at note 55, supra.

100 WBG, supra note 98, at 4, 26 & n. 3.

101 WBG, Doing Business 2020: Economic Profile Japan (2020), at 51-59 [WBG, Japan], https://www.doingbusiness.org/content/dam/doingBusiness/country/j/japan/JPN.pdf. The SLR index represents 60% of the overall score on getting credit (the other 40% being the “credit information index.” WBG, supra note 98, at 26 & n 3.

102 WBG, Japan, supra note 101, at 52, 54 (Tokyo), 56, 58 (Osaka).

103 Actually, the rule likely would be a “first-to-register-or-take-(physical) possession” rule for movables, assuming that a possessory pledge and an actual physical delivery would remain effective methods of third-party effectiveness.
For example, assume Creditor A registers an assignment at Time 1 (T-1), but the assignor (debtor) does not make an assignment at that time (perhaps because no loan had yet been made). At T-2 Creditor B registers an assignment and the assignor assigns to Creditor B the same movables that were covered by Creditor A’s registration. At T-2 Creditor B has priority—it is the only assignee of the collateral and there is no priority conflict. At T-3, however, the assignor actually assigns the movables to Creditor A. Now Creditor A has priority under the first-to-register priority rule. Any other rule or result would make it impossible to determine priority from the public record alone and would defeat the purposes of public notice and the priority rule. Moreover, Creditor A would have priority even if it had knowledge of the assignment to Creditor B at the time the assignment was made to Creditor A. Creditor B, in our example, should have searched the record, discovered the registered assignment to Creditor A, and refused to make a loan unless Creditor A terminated its registration or subordinated its interest to that of Creditor B.

Adopting a first-to-register priority rule would not make it necessary to eliminate the general third-party effectiveness of a Minpō assignment, however. For example, an assignee that would be willing to assume risks associated with an assignor’s earlier assignment or subsequent registered assignment, could nonetheless achieve protection against judgment creditors and an insolvency representative by employing a Minpō method of effectiveness.

2. Simplifying Descriptions of Collateral

Another significant move toward modernizing Japan’s secured transactions laws would be the relaxation of the current demanding requirements for describing collateral for purposes of PRAMC registration and jotō tanpo assignments. For both purposes a collateral description should be sufficient if it reasonably identifies the collateral. And for a third-party searcher of the PRAMC registry, the description should be adequate if it puts the searcher on notice as to the property that might be covered by an assignment,

104 This possibility might require adjustments to PRAMC or the relevant associated ordinances. The first-to-register priority rule contemplates that an assignment could be registered under PRAMC even before the assignment were made effective between the parties. If registration could not be effective until value were given for the assignment, the creditor-assignee would in effect be required to extend credit on an unsecured basis pending registration in the case of receivables collateral. Even if the creditor were to receive a fictitious delivery of movables pending registration, it could not be assured of its priority status until registration occurred.

105 Even though the assignor in the example has already assigned the movables to Creditor B, it is implicit in the first-to-register priority rule and the fact of Creditor A’s earlier registration that the assignor retains the power to assign the movables to Creditor A. This is consistent with Japanese Supreme Court jurisprudence that has recognized the creation of a jotō tanpo title transfer that is junior to an earlier jotō tanpo transfer. See Saikō Saibansho [Sup.Ct.] July.20,2006, no.948,60 [MNSHTC] 2499.

106 This result would be in accord with the priority rules under UCC Article 9 and under the Model Law. UCC § 9-322(a)(1), cmt. 4, ex. 1; Model Law, art. 45.

107 We are mindful that some non-professional creditors wishing to rely on Minpō methods might not appreciate the risks imposed by a first-to-register priority rule. Consideration might be given to an exception to that priority rule that would favor such creditors. The exception might be available, for example, to a creditor not regularly engaged in the business of extending credit or for casual or isolated transactions that cover only an insignificant portion of the assignor’s assets of the type involved.
although further inquiry of the debtor-assignor might be required. For example, permitting broad descriptions such as “all of assignor’s business equipment and inventory now owned or hereafter acquired” or “all of assignor’s receivables now existing or hereafter arising” should be sufficient for both purposes. For purposes of registration, an even more relaxed standard that would permit descriptions such as “business equipment” would serve the purpose of public notice, leaving to further inquiry the details of the actual assignment.  

We offer these suggestions as to the appropriate level of detail as examples. Other approaches might well suffice. A thorough consideration of the issues related to collateral descriptions is important and necessary, but that is beyond the scope of this paper. Our central point here is that the requirements should permit more flexible use of standardized descriptions (including those that would cover substantially all of a debtor’s movables and claims for purposes of assignments and registrations without the need for the routine involvement of shihō shoshi).

3. Addressing the “Overcollateralization” Doctrine

For the modification of collateral description standards just discussed to achieve the most benefits, it also would be necessary to overcome the public-policy concerns expressed by the Supreme Court, sometimes referred to as arising from “overcollateralization.” We take seriously the concerns about creditor conduct that might impose unreasonable and inappropriate restrictions on a debtor’s business activities or inflict unjust disadvantages on other creditors, such as by a creditor’s exercise of excessive control over a debtor’s business or assets. But we see no basis to believe that a security interest (including a jōto tanpo assignment) in substantially all of a debtor’s personal property necessarily (or even plausibly) would alone amount to such an abuse. Moreover, a contrary view would suggest that an important attribute of the Model Law would violate the public policy of Japan. Instead, the application of tort law and the development (judicially or by statute) of doctrines that directly address creditor misbehavior would be a more appropriate response.

108 For third-party searchers of the PRAMC registry a second step further inquiry is already necessary because a search does not identify the movables or claims that have been assigned. See infra subpart B.4. Given that, there may be little value added in requiring that a more detailed description be placed in the public record.

109 For example, consider the simplified approach to references to collateral under the UCC in the United States. See HARRIS & MOONEY, supra note 30.

110 See supra Part II.

111 See, e.g., U.S. Bankruptcy Code, 11 U.S.C. § 510(c)(1) (subordination of claims under principles of equitable subordination). We doubt that requiring a registration of an assignment to indicate a maximum amount that is secured by the assigned collateral would be a satisfactory approach, although that option is provided by the Model Law. See Model Law, art. 6(3)(d) (setting out this optional requirement in square brackets). As explained in the Secured Transactions Guide, such a requirement might “limit the amount of credit available from the initial creditor” and might “be ineffective in practical terms as the initial secured creditor will simply require the grantor to consent to an inflated maximum sum.” Secured Transactions Guide, supra note 7, at 173.
Adopting a first-to-register priority rule, simplifying collateral descriptions, and tempering the overcollateralization doctrine would make it possible for a debtor to create a first-priority security interest in substantially all of its personal property assets if the debtor chose to do so. But incorporating such flexibility into the legal system would not mean that such simplistic stereotypical “all assets” transactions would be the norm. The United States experience supports this conclusion. Some encouragement for reforms along these lines may be gleaned from a recent FSA guidance suggesting that use of all assets of a debtor as collateral may be helpful for the rehabilitation of financially distressed SMEs. This FSA support also would be consistent with the FSA’s recent emphasis on market mechanisms, innovation, and flexibility.

The reforms proposed here provide ample support for the creation of security over a debtor’s whole business. The same can be said of the provisions of the Model Law, UCC Article 9, and the personal property security acts of Canada, New Zealand, and Australia. In particular we strongly discourage the adoption of revisions to Japanese law that would embrace any system similar to the English law floating charge/fixed charge regime. That would introduce enormous unnecessary complexity, such as solutions for priority issues between floating and fixed charges and the resolution and application of a “crystallization” trigger. We note that this approach has been rejected in the Model Law and in UCC Article 9 and even in traditional common-law jurisdictions that have adopted modernized secured transactions laws, such as Canada, New Zealand, and Australia. Moreover, without more the various problems and potential reforms addressed here would remain and would need to be addressed.

4. Addressing the “Crystallization” Doctrine

As described above, under the doctrine of “crystallization,” transfers outside of the ordinary course of inventory from the aggregate of the body of inventory before crystallization may be clawed back, provided that there is no bona fide acquisition by a third party, but once a crystallization has occurred a security interest in inventory subsequently acquired would not be effective. This subsequently acquired inventory

---

112 The statement in the text refers to personal property generally and should be qualified with respect to property subject to special laws such as agricultural goods, automobiles, aircraft, ships, and intellectual property.
113 See infra Part V.D.
114 FSA, Fight Against COVID-19 and Develop a Better Post-COVID Society, JFSA Priorities for July 2020-June 2021, at 5-6 (2020) (“We pursue practical possibilities of a blanket security interest [i.e., over the whole business] that could encourage financial institutions to comprehensively support borrowers’ business continuity and enhancement.”).
115 See notes 46-51, supra, and accompanying text, (discussing FSA’s new supervisory approaches).
118 See supra Part II.
would include property that otherwise is or would be the subject of the assignment made effective under the Minpō or pursuant to a PRAMC registration. Of course, the enforcement against any collateral must identify the relevant collateral. This is especially clear in the case of judicial enforcement. But we see no policy basis for the limitation imposed by the crystallization doctrine on assets acquired post-crystallization being subject to jōto tanpo. Certainly the modern principles as embodied in the Model Law do not view individual movables or claims as a part of an “aggregate” merely because they are continually acquired and disposed of or collected. Nor is there any provision of the Minpō that would mandate the “aggregate” conception of such collateral on which crystallization is based. These applications of crystallization also appear to be incompatible with maximizing the “going business” value of collateral in the enforcement of a security interests.

Apart from the issue of crystallization, whether future assets acquired after the commencement of an insolvency proceeding are covered by a pre-commencement assignment presents an entirely different matter from a policy perspective. In the interest of rehabilitation, it may be necessary and appropriate for post-commencement future assets to be free of a pre-commencement assignment covering future assets.119

5. Applicability of PRAMC to Individual Assignors

We also would favor revising PRAMC to cover assignments by natural persons as well as by juridical persons. This revision would meet concerns expressed by several bankers during our interviews. It also would make the benefits of the PRAMC registry (as enhanced by the other revisions proposed here) available for the many SMEs in Japan that are owned and operated by individuals. We note that indexing according to the names of natural persons in a registry (such as the PRAMC registry) may present problems that are not present in the case of the names of juridical persons. But the use of names or other debtor or assignor identifiers generally have been adequately dealt with in other modern secured transactions laws.120

6. Insolvency Law Reforms (Including Automatic Stay and Relief From Stay)

The UNCITRAL Legislative Guide on Secured Transactions and the UNCITRAL Legislative Guide on Insolvency Law121 (Insolvency Guide) each recognizes the importance of the respect for security interests in insolvency proceedings. But they also recognize that achieving the goals of insolvency law (and in particular rehabilitation) may require that the rights of secured creditors be modified in insolvency proceedings.122

119 See infra subpart A.6 (discussing post-commencement property).
122 See Secured Transactions Guide, supra note 7, at 425; see also Mooney, supra note 7, at 39-40.
There should be an appropriate balance between the goals of insolvency law and the operation of non-insolvency law applicable to secured transactions.

The failure of Japan’s Civil Rehabilitation Act\textsuperscript{123} to routinely stay enforcement of and administer secured claims may reflect an example of a failure to observe such a proper balance. Revision of that law to provide for such a stay and administration, or the adoption of appropriate standards for the discretionary imposition of a stay, would be consistent with the balance contemplated by the Insolvency Guide. This also would be consistent with the general recognition globally that a stay of enforcement may be an important component of an effective rehabilitation or restructuring law.\textsuperscript{124} However, a stay also should be accompanied by appropriate safeguards to protect the rights of secured creditors. Ensuring that property acquired after the commencement of an insolvency proceeding is free of a pre-commencement assignment also would be appropriate (except as to proceeds of pre-commencement collateral).

We are mindful that debtors and secured creditors in civil rehabilitation proceedings typically reach an agreement for the debtor’s continued operation and use of collateral, the court is empowered to stay enforcement of security interests under the Civil Rehabilitation Act,\textsuperscript{125} and actual enforcement may be rare in this setting. Even so, a secured creditor’s right to enforce against collateral in the absence of a stay of enforcement may foster an inappropriate imbalance in the parties’ bargaining power.

B. WBG Ranking and Additional Reforms

1. “All Assets” Collateral

The reforms proposed above in A. 2. (simplified description of collateral) and 3 (elimination of overcollateralization doctrine) would support a “yes” answer to the third question in the SLR index:

“What does the law allow businesses to grant a non possessory security right in substantially all of its [sic] assets, without requiring a specific description of collateral?”\textsuperscript{126}

Arguably the reform proposed in A.4, elimination of the “crystallization” doctrine, might also be considered a significant factor for answering the third question,

\textsuperscript{123} Minji Saisei Hō, Law No. 225 of Dec. 22, 1999, as amended by Law No. 571 of 2019 [Civil Rehabilitation Act].

\textsuperscript{124} UNCITRAL, supra note 120, at 87-88, 101-02. Of course, such a stay need not be absolute. For example, the stay might be imposed for a limited time (such as 10, 20, or 30 days) with an extension available only if continuation is justified and favorable prospects for a debtor’s rehabilitation exist. The burden of proving grounds for continuation or termination might be placed on either the debtor or the creditor. We note that this approach also could respond to potential opposition to secured transactions law reforms from the community of Japanese insolvency law professionals, who may perceive the strengthening of the rights of secured creditors as a threat to the goals of rehabilitation.

\textsuperscript{125} Civil Rehabilitation Act § 31(1).

\textsuperscript{126} WBG, supra note 98, at 54, 58.
depending on the scope of the doctrine. But in our view that step would not be necessary for an affirmative answer to the third question, which addresses only the “grant” of a security right.

2. Generally Applicable PRAMC Registry for All Debtor Entities

The proposed reforms described in A.1 and 5. would support a “yes” answer to the sixth question in the SLR index:

“Is a collateral registry in operation for both incorporated and non-incorporated entities, that is unified geographically and by asset type, with an electronic database indexed by debtor’s name?”

The proposed revision in A.5. would expand the PRAMC registry to include assignments by individuals, making it applicable to both “incorporated and non-incorporated entities.” Without this change in law, the proposed revision in A.1, calling for a first-to-register priority rule, would not alone affect the WBG ranking. That such an important reform, conferring coherence on the PRAMC registration system, would not have any impact on the WBG rankings illustrates one of many flaws in the “blunt” WBG rankings regime. Although the sixth question does not explicitly mention the priority afforded by registration in a collateral registry, we are confident that given Japan’s current priority rule the existing PRAMC registry would not qualify. The proposal in A.1. would rectify this concern.

Whether the PRAMC registration system as so modified would be “unified . . . by asset type” is a more difficult question. The PRAMC regime applies only to assignments of movables and claims, which clearly are the assets typically contemplated by ABL in Japan. We are uncertain whether its failure to cover intangibles other than money claims would prevent Japan from providing an affirmative answer to the sixth question. But given the importance of movables and claims we believe a strong case could be made that this limited scope of PRAMC should not be disqualifying.

3. “Notice-Based” Registration and Transactional Scope of PRAMC Registration System

Consider next the seventh question in the SLR index:

“Does a notice-based collateral registry exist in which all functional equivalents can be registered?”

\(^{127}\) Id.  
\(^{128}\) Id.
Adoption of the simplified requirements for registration should transform the PRAMC registration system into a “notice-based registry.” But the registry’s limitation to title-transfer transactions for movables would disqualify it from applying to “all functional equivalents.” Statutory pledges of movables are conspicuously absent from PRAMC’s scope. Arguably, adding pledges to its scope might not be controversial, especially inasmuch as jōto tanpo is the predominant transactional structure for ABL. As a policy matter, Japanese law already accepts the concept of public registration as a functional equivalent of possession of movables. Even with such a change for pledges, the question would remain as to whether title-reservation transactions are “functional equivalents,” the omission of which from PRAMC’s scope would prevent Japan from giving an affirmative answer to the seventh question. As with the sixth question, moreover, we also are uncertain whether the limitation of PRAMC’s applicability to assignments of movables and claims might prevent an affirmative answer to this question as well.

We suspect that making PRAMC applicable to title-reservation transactions would be required for an affirmative answer to the seventh question. If this approach were adopted, however, then as with jōto tanpo assignments made effective under the Minpō, unregistered title-reservation transactions could remain generally effective as against third parties. Moreover, as a form of acquisition or purchase-money financing, registered title-reservation transactions might be given a super-priority over earlier-in-time registered security interests.

Notwithstanding the potential benefits of an enhanced WBG ranking (and there being no basis for exempting title-reservation transactions from the registration requirement under the modern principles), we would anticipate substantial opposition to subjecting title-reservation transactions to the PRAMC regime. Moreover, our interviews did not reveal substantial support among bankers for such a move that would upset the current law and business practice that title reservation transactions are effective without any further step.

4. Online Access to Registry and Third-Party Searches

The eighth question in the SLR index addresses online access to the collateral registry:

---


130 Note that pledges of claims are within the scope of PRAMC. PRAMC art. 14.

131 Notwithstanding this policy point, however, we appreciate that subjecting statutory pledges of movables to the PRAMC registration regime would introduce various conceptual difficulties and drafting challenges in connection with the Minpō reliance on possession in its treatment of pledges.

132 See Model Law, art. 38 (priority of acquisition security rights); Uniform Commercial Code § 9-324 (priority of purchase money security interests).
“Does a modern collateral registry exist in which registrations, amendments, cancellations and searches can be performed online by any interested third party?”\(^{133}\)

Online access to the PRAMC registration system is permitted.\(^{134}\) The principal obstacle for Japan in giving an affirmative answer to the eighth question is the limited scope of the searches of the PRAMC registry that third parties are entitled to request.\(^{135}\) Third-party searchers are entitled to request only a “Certificate of Summary of Registered Matters,” which identifies registrations of assignments made by an assignor in the PRAMC registry, but does not contain a description of the movables or claims that are assigned.\(^{136}\) Only parties with a direct interest in the transaction, such as the assignor or assignee, an attaching creditor, or the obligor on an assigned claim, are entitled to request and obtain a “Certificate of Registered Matters,” which does contain a description of the assigned property.\(^{137}\) In practice, this structure means that an interested third-party can obtain access to the collateral descriptions only by seeking the assistance and cooperation of a person with possession of that information or the right to request it from the registry.

This limitation on searching may not cause serious problems as a practical matter, though it likely adds to transaction costs that over time for all persons concerned may be quite substantial. More significant, perhaps, we are unaware that the absence of such limitations on the rights of third-party searchers in jurisdictions with modern secured transactions laws, such as in the United States, has created any problems or given rise to any controversy. Similarly, no such limitation is imposed or recommended by the UNCITRAL Model Law or related texts and we are unaware that any controversy about this issue arose in connection with the UNCITRAL secured transactions activities. We understand that the third-party search restriction in PRAMC arose from concerns about privacy,\(^{138}\) but clearly Japan is an extreme outlier in this respect. We would support a revision of PRAMC that would eliminate the limitation. With such a revision Japan could answer “yes” to the eighth question.\(^{139}\)

5. Products, Proceeds, and Replacements of Collateral

Next consider the fourth question in the SLR index:

\(^{133}\) WBG, \textit{supra} note 98, at 54, 58.
\(^{134}\) Ordinance No. 39 (1998), arts. 24, 26.
\(^{135}\) We note the infelicitous language of the eighth question, which literally asks whether an interested “third party” could perform registrations, amendments and cancellations. Obviously only transaction parties could perform those functions. For example, registrations under PRAMC are made only upon applications of the assignor and assignee. See e.g., PRAMC arts. 7(2) (assignment of movables); 8(2) (assignment of claims). We interpret the question as addressing the online performance of those actions and the reference to a “third party” as applying only to searches.
\(^{136}\) PRAMC, art. 11(1).
\(^{137}\) PRAMC, art. 11(2).
\(^{138}\) \textit{UEGAKI} & \textit{OGAWA}, \textit{supra} note 24, at 115-121.
\(^{139}\) Our view notwithstanding, once again the limitation on the scope of PRAMC to title-transfers transactions and to assignments only of movables and claims arguably calls into question whether the registry is a “modern collateral registry” as contemplated by the eighth question.
“May a security right extend to future or after-acquired assets, and does it extend automatically to products, proceeds and replacements of the original assets?”

Although a jōto tanpo assignment may include assets that are acquired or come into existence in the future, the assignment does not automatically extend to “products, proceeds and replacements.” In general, it is considered that a jōto tanpo assignee may acquire proceeds of the original collateral through subrogation, but subrogation may also require a procedural step such as a judicial attachment of the proceeds and it may be defeated if the proceeds are transferred by the assignor/debtor before an attachment.

We are sympathetic as a matter of policy to reforms that would automatically extend a jōto tanpo assignment (as well as pledges and title-retention transactions, if they were subject to a unified system of security) to proceeds, products and replacements of original collateral, thereby allowing Japan to answer “yes” to the fourth question. This extension would be particularly important in the setting of an insolvency proceeding. For example, it could provide an appropriate exception to a generally applicable rule that would not permit security interests to extend to future assets acquired after the commencement of an insolvency proceeding. We note however that implementing such a reform under Japanese law would face some complexities and headwinds. For example, under current law products, proceeds, and replacements receive differing treatment, subrogation does not apply to receivables, and the concept of proceeds of proceeds would be new.

6. Automatic Stay and Relief from Stay in Court-Supervised Reorganization Proceeding

The eleventh question in the SLR index relates to the automatic stay and relief from stay in a reorganization proceeding:

“Are secured creditors subject to an automatic stay on enforcement when a debtor enters a court-supervised reorganization procedure? Does the law protect secured creditors’ rights by providing clear grounds for relief from the stay and sets [sic] a time limit for it?

The reforms proposed in A.6. would allow Japan to answer “yes” to the eleventh question.

7. Unified Framework for Secured Transactions

140 WBG, supra note 98, at 54, 58.
141 The Supreme Court has accepted the application of subrogation for jōto tanpo. Saikō Saibansho [Sup.Ct.] May.17,1999, no.2,53 [MINSHÛ] B63. However, there are academic views that would deny subrogation for jōto tanpo transactions. HIROTO DOGAUCHI, TANPO BUKKEN HÔ [SECURITY INTEREST LAW] 9-10 (4th ed. 2017) (in Japanese).
142 It is unclear whether or not procedural requirements such as attachment apply. For an academic view that would require attachment, see Akio Yamanome, Ryūdo dōsan jōto tanpo no hôteki kōsei, 65-9 HÔRITU JIHÔ [HÔJ] 24 (1993).
143 WBG, supra note 98, at 54, 58.
The first question in the SLR index relates to a unified framework for secured transactions:

“Does an integrated or unified legal framework that extends to the creation, publicity and enforcement of functional equivalents to security interests in movable assets exist in the economy?”

This is the seventh and final question in the SLR index discussed here and to which Japan has provided a negative answer. As we understand the first question, an affirmative answer for Japan would necessitate law reforms that would integrate and unify at least the laws relating to jōto tanpo assignments, pledges, and title-reservation transactions. By way of comparison, the other reforms proposed here reflect relatively discreet (albeit significant) revisions to PRAMC and the Minpō (or the enactment of laws that would override those statutes). Reforms that would support an affirmative answer to the first question, in contrast, would require major surgery to the Japanese private-law framework. While we support in principle the idea of a unified framework that would be consistent with the emerging modern principles, we suspect that this approach may be a step too far for Japan at this time.

C. Other Law Reforms

Consideration of secured transactions law reforms in Japan should not be limited to the commercial, private law issues and insolvency law issues that we discuss here. Another area that is ripe for consideration are the current structure and practices for CGC guarantees and JFC financing. For example, adopting policies that provide incentives for beneficiaries of guarantees to adopt ABL could enhance capacity building and experience within the banking and SME sectors. The bank regulatory environment for ABL is another area that should be considered for reforms. Easing requirements for capital relief for ABL transactions also could provide incentives for the increased use of ABL.

V. POTENTIAL IMPACT OF SECURED TRANSACTIONS LAW REFORMS IN JAPAN

This Part offers our assessment of the potential impact and various shapes that ABL in Japan might take if the principal reforms advocated here were adopted. We expect that post-reform secured financing would reflect a variety of structures, some reminiscent of financing patterns in other jurisdictions and some influenced by the particular characteristics of the Japanese markets.

\[144\] Id.
\[145\] That said, one participant at the JRS Conference suggested that even a more modest step of combining the registration systems for claims and movables under PRAMC could encourage and simplify ABL. See also UCHIDA, supra note 14 (proposing a registration system that would be limited to jōto tanpo security interests and, unlike the PRAMC system, would not apply to outright transfers of movables).
A. Valuation-based ABL ("Borrowing Base" Valuation of Inventory and Receivables)

To the extent that ABL would increase as a result of these law reforms we would expect some corresponding increases in transactions in which lenders rely on valuations of collateral as a significant factor in determining the amount of credit to be extended. For example, a formal "borrowing base" revolving credit arrangement conditions the permissible amount of credit to a fraction of the valuations of inventory (such as 60%) and receivables (such as 75%). Valuations might be based on appraisals or on "book" (cost) values. However, we would not expect such financings to substitute collateral valuations for prudent analyses of a borrower’s creditworthiness. In practice we understand that even in markets such as the United States with modern secured transactions laws financings that rely primarily on collateral values for assurance of repayment are quite limited—securitization transactions and short-term credit secured by marketable securities being examples.

B. Lender-Borrower Relational-Based Secured Financing

A reform-induced increase in ABL might be thought to result in an increase in relationships in which a "main" bank lender is a borrower’s principal supplier of financing. Reforms that would encourage giving security interests in substantially all of a borrower’s personal property and ensuring first-to-register priority arguably might encourage these relationships. On the other hand, in Japan it is not unusual for an SME to have financing relationships with multiple banks. In those situations, we might expect to see multiple banks entering into arrangements for sharing collateral on a pro rata (or another) basis through inter-creditor agreements. There is no reason to assume or believe that a first-to-register priority rule would necessarily result in a single bank secured lender being the norm.

C. Monitoring of Borrower vs. Monitoring of Collateral

Collateral is not necessary for a lender to effectively monitor a borrower’s business operations and performance and financial condition. For example, financial covenants, reporting requirements, and routine examination and analysis of financial statements are not unusual in unsecured financing arrangements. But collateral, especially if it is the basis for favorable regulatory treatment, may provide further incentives for monitoring as well as facilitating monitoring from an operational perspective. For example, the role of valuations of inventory and receivables in a borrowing base credit arrangement inherently incorporate a monitoring function.

D. Examples: Financing Patterns in United States

CGCs might play a significant role in encouraging such multi-bank relationships. See FWG Report, supra note 67, at 13-14 (SMEA expects new roles of CGCs to emphasize importance of communications among CGCs and banks).
Financing patterns in the United States for SMEs provide examples of the roles and impact of personal property collateral considered in subparts A, B, and C, above. But approaches vary widely depending on variables such as a particular lender’s approach, the nature of a borrower and its business, and their respective policy choices.

So-called “all-assets” secured financing is quite typical in the case of bank loans to SMEs, but exceptions abound. When a bank that is the principal lender to an SME obtains a security interest in substantially all of the personal property assets of a borrower, in many cases credit is extended on the basis of the SME’s cash flow and business prospects. Often there is no formal borrowing base arrangement, and no formal valuation of the collateral is made. Although other creditors (typically unsecured trade creditors) rank behind the secured lender, those creditors may take substantial comfort from the borrower’s ongoing relationship with its principal bank lender. The availability of the bank credit offers considerable assurance as to the borrower’s continuing ability to pay its trade creditors.

Purchase-money, acquisition secured financing generally has priority over an earlier-perfected-security interest in a borrower’s equipment (such as that held by an “all-assets” secured lender). Such secured financing is ubiquitous for the acquisition of new business equipment in the United States. These financings often are structured as secured sales by a dealer and subsequent assignments (by way of outright sales or a secured loans) of the secured right to payment to third-party assignees.

Although such “all assets” secured relational financing arrangements and acquisition equipment financing transactions are common, secured and unsecured financing patterns in the United States reflect a rich, diverse, and continually evolving variety of structures. It is commonplace for borrowers, including SME borrowers, to have multiple secured creditors with the statutory priority rules supplemented and modified by contractual inter-creditor agreements. In recent years “second-lien loans” have surged, for example.\(^{147}\)

The United States experience suggests that adoption of the modern principles is consistent with a wide variety of financing patterns. Credit markets, however, are shaped by many influences other than the local legal regime. While law reforms in Japan embracing the modern principles could offer enhanced flexibility and efficiencies, we would expect that post-reform practices in Japan would reflect its own set of distinctive patterns.

E. Significance of Secured Transactions Law in Post-COVID 19 Economy

It appears that the economic downturn provoked by the current pandemic is and will continue to be severe for a substantial period of time. But no one doubts that in

general business cycles are a normal part of the financial and business landscape in market economies. In times of stress for a business an efficient legal regime for secured transactions may provide a crucial lifeline. Moreover, the enhanced government support for SME credit that has emerged during the current crisis, in Japan and in many other countries, at some point may have to yield to political and fiscal realities. Reforms to secured transactions laws could make possible important credit enhancements during such a transition and thereafter.\textsuperscript{148}

F. Overarching Impact of Reforms

1. Facilitating Credit

Modern secured transactions laws and the prospect for increases in the use of ABL in Japan should not be seen as ends in and of themselves. The principal potential value of reformed secured transactions laws is the facilitation of credit that otherwise would not be extended or that would be extended at a higher cost or in a smaller amount. In the current low-interest rate environment it seems clear enough that reducing obstacles to ABL in Japan is unlikely to materially reduce the cost of credit (at least in the near term). However, the law reforms advocated here could well play an important role, at the margin, in encouraging extensions of credit that otherwise would not be made—especially for distressed SMEs. In the longer term and in a world of higher interest rates, these reforms could serve to lower the cost of credit. Moreover, they also could provide an important mechanism for reducing the role of government credit supports and reducing the costs of supports that continue.

2. Secured Transactions Law as a Simplified, Coherent, and Flexible “Toolkit”

Perhaps the most significant and important, although less dramatic, impact of the reforms discussed here would be the increased simplicity and coherence of the law governing secured transactions. In our view it would be an unreasonable standard to condition support for improvements to the private law on the expectation of an immediate, direct, and measurable impact on the credit markets. As discussed in this article, a consensus has emerged that the modern principles reflect the best approach for creating an efficient and effective secured transactions framework. Moving Japan’s secured transactions laws toward the modern principles could provide banks and other lenders and their SME borrowers with a simplified, more coherent, and flexible “toolkit” for business financing. In sum, we see little to commend the continued maintenance of the expensive, complicated, and uncertain legal framework that currently exists.

VI. SOME OBSERVATIONS ON THE ROLE OF QUALITATIVE EMPIRICAL RESEARCH IN LAW REFORM

\textsuperscript{148} For example, the FSA’s policy paper on 2020-2021 priorities stresses that during the pandemic financial institutions need to stay informed as to the credit risk and business viability of their borrowers. The paper proposes that the establishment of all-assets security interests would serve this purpose as a means of monitoring a borrower’s cash flow and assets. FSA, \textit{supra} note 113, at 5-6.
The JBCP raises implications and provides lessons for law reform efforts beyond the details of Japanese secured transactions laws and, indeed, beyond secured transactions law reforms more generally. Not only do law reform efforts face obstacles in the process of enacting statutes but the laws once on the books may go largely unused. For example, “flawed” as Japanese secured transactions law may seem from the perspective of some legal academics, certainly it would plausibly support substantially more transactions than currently take place. Adoption of the modern principles cannot alone overcome impediments such as stigma, low-cost unsecured credit, thin secondary markets, and regulatory disincentives. On the other hand, the suboptimal use of ABL, for example, does not justify maintenance of a legal regime that does not meet the needs of those who would, were it available, employ the more accessible, user-friendly, reliable, and efficient framework contemplated by the modern principles.

Data abounds in Japan as to sources of business credit in Japan, the business debtors who obtain credit, and the nature and purposes of business credit. But the JBCP has sought to explore the puzzle of why the prevailing landscape and legal regime exists. It has explored the causes of the market characteristics, how they have developed, and some underlying cultural and legal other influences. To be sure, we have not discovered any deep, dark secrets. Indeed, the information we have gathered and assessed was obtained from bankers, government officials, and legal professionals. Through our interviews we have identified lending practices and policies adopted by bank lenders and the relationships between these practices and policies and the legal regime. This has allowed us to propose needed reforms based on a realistic and practical assessment of the role of the relevant legal rules. Projects such as the JBCP may serve to synthesize and disseminate information that is essential for lawmakers and others involved in the law reform process.149

VII. SUMMARY AND CONCLUSION

In this article we have set the stage with an overview of Japanese secured transactions law and described the key findings from the interviews we have conducted in connection with the Japan Business Credit Project. We have identified several problems under the current legal infrastructure and proposed some specific reforms to address those problems. The proposed reforms would move Japanese law toward the modern principles exemplified by the UNCITRAL Model Law on Secured Transactions.

149 As one of us has expressed:

[R]eform processes would benefit from more rigorous studies of approaches to secured transactions law reforms beyond the mere adoption of statutes and guidance from closely related texts. In addition to academic research projects such as the JBCP, reform efforts also would benefit greatly from a more systematic approach to the use—and memorialization in the literature—of experiences and lessons learned from work of individuals and organizations “on the ground” in the process of implementing reforms.

However, our proposals also take account of the special circumstances and needs of the Japanese business credit markets. We also have pointed out how the proposed reforms along with some additional modest reforms could materially improve Japan’s standings in the World Bank Group Doing Business Rankings.

We have offered our views on the potential impact of secured transactions law reforms in Japan and identified several potential benefits of these reforms. Finally, we have explained the value and utility of qualitative empirical research such as the JBCP for the process of law reform.