

Lending and taking security in Japan: overview

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A Q&A guide to finance in Japan. The Q&A gives a high level overview of the lending market, forms of security over assets, special purpose vehicles in secured lending, quasi-security, guarantees, and loan agreements. It covers creation and registration requirements for security interests; problem assets over which security is difficult to grant; risk areas for lenders; structuring the priority of debt; debt trading and transfer mechanisms; agent and trust concepts; enforcement of security interests and borrower insolvency; cross-border issues on loans; taxes; and proposals for reform.

To compare answers across multiple jurisdictions, visit the [Lending and taking security in country Q&A tool](#).

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Overview of the lending market

1. What have been the main trends and important developments in the lending market in your jurisdiction in the last 12 months?

In Japan, highly accommodative financial conditions have continued in 2018. This is a result of applying "Abenomics" (the pro-growth policies of Prime Minister Shinzo Abe that focus on pulling the Japanese economy out of deflation) and quantitative easing by the Bank of Japan.

In light of the above monetary easing, the lending market in Japan has continued to function well, supporting a moderate expansion of the Japanese economy. Specifically, in terms of domestic loans, financial institutions' outstanding domestic loans have continued to grow at a year-on-year rate of around 2%, and lending to small firms has especially increased across a wide range of industries.

Lending to the real estate industry has also increased, and major banks have mainly extended loans to real estate funds, including real estate investment trusts (REITs) and private real estate funds. Since the Japanese Yen has been weak against other major currencies recently, inbound real estate investments into Japan have been noteworthy. Although investments for renewable energy power plants in Japan were also brisk in 2018, the tendency may be changing in 2019 with the enforcement of the amended feed-in tariff rules for renewable energy power plants.

M&A deals in 2018 reached a record high in Japan in 2018-2019 and consequently loan markets for M&A were also vibrant. In terms of overseas loans, banks' overseas loans have continued to grow moderately, and at major banks overseas loans currently account for about 30% of all loans. Under these circumstances, major banks have continued to acquire and invest in local banks, mainly in Asia.

Finally, the amendment to the Civil Code will, to a certain extent, affect the lending and creation of security interests in practical terms. More specifically, the amendment will affect documentation relating to loans, guarantees and collaterals and will alter certain procedural aspects of guarantees. The amendment will be made effective on 1 April 2020 (Amended Civil Code).

Forms of security over assets

Real estate

2. What is considered real estate in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected (that is, made valid and enforceable)?

Real estate

Under most statutes, land and any fixtures on it comprise real estate (immovable property) (*Article 86.1, Civil Code (Minpou)*). Buildings are the most common type of fixture and are subject to a property registration system separate from that of land (*Article 44, Real Property Registration Act (Fudousan-touki-hou)*).

Common forms of security

Common forms of security interests over real estate are:

- Security interests under statutes, such as:
 - mortgages (*teito-ken*);
 - umbrella mortgages (which function like a revolving mortgage (*ne-teito-ken*));
 - pledges (*shichi-ken*) over immovable property;
 - statutory liens (*sakidori-tokken*) on immovable property which is granted to a claimant who has a claim arising from the preservation of the immovable property, construction work on the immovable property or the sale of the immovable property;
 - repurchase arrangements (*kaimodoshi*); and
 - provisionally registered ownership transfers (*kari-touki-tanpo*).
- Security interests recognised by court precedents (without any statutes providing for these security interests), such as:
 - security interests by way of assignment (*joto-tanpo*) (security assignments);
 - pre-agreed resale transactions (*sai-baibai-no-yoyaku*); and

- retentions of title (*shoyuuken-ryuuho*).

The most common forms of security are statutory mortgages and revolving mortgages:

- **Mortgages (Article 369, Civil Code).** A mortgage gives the secured creditor a preferential right relating to the value of the mortgaged property, and allows it to receive payments from the proceeds of the mortgaged property before other creditors.
- **Revolving mortgages (Article 398-2, Civil Code).** A revolving mortgage is a type of mortgage, but the claims secured by it are not specified at the time of its creation.

Formalities

Mortgages and revolving mortgages are created by agreement (not necessarily in writing) between the creditor and the owner of the immovable property, and are perfected by registration in the relevant property registry (*Article 177, Civil Code*).

However, the agreement creating a revolving mortgage must specify:

- The scope or type of claims to be secured (usually specified by identifying the transaction type, for example, "lending money transaction").
- The maximum amount to which the revolving lender has preferential rights (that is, open revolving mortgages are not allowed).

Tangible movable property

3. What is considered tangible movable property in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected?

Tangible movable property

Any tangible thing or item (*butsu*), which is not real estate, comprises movable property (*Articles 85 and 86.2, Civil Code*).

Not all movable property receives the same legal treatment. For example, mortgages cannot be created over typical movable property. However, construction machinery, as well as aircraft and registered ships, can be subject to mortgages under certain specific statutes that provide exceptions to the Civil Code.

A pool of movable properties is not recognised as a single movable property. This is because the concept of a thing or item under the Civil Code is based on tangibility. Further, a single right cannot be established over a pool of movable properties under the legal doctrine that only grants a single right over a single property (subject to limited exceptions).

However, particularly in relation to trading stock (inventory), the Supreme Court has recognised that a pool of movable properties can be subject to a single security interest, if the scope of the subject matter is specified in some way (such as by designating the type, location and quantity of the movable properties in the pool).

Common forms of security

Common forms of security interests over movable property are:

- Security interests under the Civil Code, such as:
 - pledges over movables;
 - statutory liens on movables; and
 - repurchase arrangements.
- Security interests recognised by court precedents, such as:
 - security assignments;
 - pre-agreed re-sale transactions; and
 - retentions of title.

The most common forms of security are pledges and security assignments.

Formalities

The formalities for creation and perfection of pledges and security assignments are as follows:

- **Pledges.** Pledges over movable property are created and granted by:
 - an agreement (not necessarily in writing) between the creditor and the owner of the movable property; and
 - delivery (which includes actual delivery, summary delivery and transfer of possession by instruction, but excludes constructive delivery) of the subject matter to the creditor.

Pledges over movable property are perfected by continuous possession of the subject matter of the pledge.

- **Security assignments.** Security assignments for movables are created and granted by a granting contract (not necessarily in writing). They are normally perfected by delivery (*Article 178, Civil Code*), but can also be perfected by registration, if the assignor (grantor of the security assignment) is a corporation (*Article 3, Act on Special Provisions, etc. of the Civil Code concerning Perfection Requirements for the Assignments of Movables and Claims (Perfection Act)*). In contrast with pledges (*see above*), delivery of the subject matter can take the form of constructive delivery, as confirmed by the Supreme Court.

The Supreme Court has also decided that a creditor can perfect its security assignment over a pool of movable properties as soon as the assignor (usually the debtor) acquires possession of new or additional movable properties that are specified as part of the pool. This is possible if the assignor and the assignee (that is, the creditor) agree that the creditor is deemed to have acquired possession of the new or additional

movable properties, by constructive delivery from the assignor to the creditor, when the assignor acquires possession of the movable properties.

Financial instruments

4. What are the most common types of financial instrument over which security is granted in your jurisdiction? What are the most common forms of security granted over those instruments? How are they created and perfected?

Financial instruments

The most common types of financial instrument over which security is granted are:

- Shares in listed companies.
- Debt securities (especially bonds).
- Trust beneficial interests (*Shintaku-jueki-ken*).

Common forms of security

The most common forms of security over financial instruments are pledges and security assignments. Different rules apply depending on the form of security:

- **Shares in unlisted companies.** The rules differ depending on whether the shares are certificated or uncertificated:
 - certificated company shares can be secured by unregistered pledge (*ryakushiki-kabushiki-shichi*), registered pledge (*touroku-kabushiki-shichi*), unregistered security assignment (*ryakushiki-joto-tanpo*) or registered security assignment (*touroku-joto-tanpo*);
 - uncertificated company shares: only registered pledges and registered security assignments can be created over uncertificated shares. However, unregistered pledges and unregistered security assignments can be created over uncertificated shares, if they are book-entry stocks (a form of dematerialised shares) (*see below*).
- **Shares in listed companies.** Share certificates for all listed companies were automatically abolished by law on 5 January 2009. Shares now accrue, transfer and extinguish, and therefore trade electronically, through accounts at the depository (at present, only the Japan Securities Depository Center, Incorporated) (Act on Book-Entry Transfer of Corporate Bonds, Shares (*Shasai-kabushiki-tou-no-furikae-ni-kansuru-houritsu*) (Transfer Act)).

Security interests over book-entry shares can be created by:

- unregistered pledges;
- unregistered security assignments;

- registered pledges;
 - registered security assignments.
- **Bonds.** Pledges and security assignments are the common forms of security over bonds, whether they are bonds with issued certificates, bonds without issued certificates, or book-entry bonds.
 - **Trust beneficial interests** (especially trust beneficial interests in real estate management and disposal trusts). In Japan, expensive real estate tends to be transacted in the form of trust beneficial interests to reduce stamp tax and to avoid certain regulation issues. Transactions involving other types of assets could also utilise trust formations for various reasons (such as to take advantage of a bankruptcy remoteness feature of trusts). Pledges are the common form of security over trust beneficial interests.

Formalities

The following formalities must be complied with:

- **Shares in unlisted companies.** The security interest is only deemed created on delivery of share certificates to the secured creditor, in addition to the execution of the granting contract. The security interests are perfected as follows:
 - unregistered pledge: continuous possession of the share certificates (*Article 147.2, Companies Act (Kaisha-hou)*);
 - registered pledge: registering or recording the lender's name and address in the company's shareholder registry (*Article 147.1, Companies Act*);
 - unregistered security assignment: continuous possession of the share certificates (against third parties other than the company (*Article 128.1, Companies Act*)), and registering or recording the lender's name and address in the company's shareholder registry (against the company (*Article 130, Companies Act*));
 - registered security assignment: registering or recording the lender's name and address in the company's shareholder registry (*Article 130.1, Companies Act*).
- **Shares in listed companies.** Both unregistered and registered pledges over book-entry shares are created by registration or entry in the pledge section of the pledgee's account, in addition to the execution of the granting contract. Although not explicitly stated in the Transfer Act, a pledge over book-entry shares is perfected by registration or entry in the pledge section of the lender's account. A pledge over book-entry shares is considered an unregistered pledge, unless the pledgee applies to the issuer to register the pledge in the issuer's shareholder registry.

Both unregistered and registered security assignments over book-entry shares are created by registration or entry in the holding section of the assignee's account, in addition to the execution of the granting contract. A security assignment can only be perfected against the issuer company by registering and recording the lender's name and address in the shareholder registry. In contrast to pledges, a security assignment over book-entry stocks is considered a registered security assignment, unless the parties agree and register otherwise.
- **Bonds.** Where bond certificates are issued, both a pledge and a security assignment over bonds are created and perfected against third parties (against the issuer and third parties for bearer bonds (*mukimei-shasai*)) by delivery of the bond certificates, in addition to the execution of the granting contract (*Articles 692 and 687, Companies Act*).

In a security assignment of registered bonds (*kimei-shasai*), perfection comprises (*Articles 688.1 and 688.2, Companies Act*):

- registering or recording the assignee's name and address in the bond registry (for perfection against the company);
- continuous possession of the bond certificates (for perfection against third parties other than the company).

Perfection of a pledge of bonds requires continuous possession of the bond certificates (*Article 693.2, Companies Act*).

Where bond certificates are not issued, a pledge and security assignment of bonds is created solely by a granting contract, and perfected by registering or recording the assignee's name and address in the bond registry (*Articles 693.1 and 688.1, Companies Act*).

In relation to book-entry bonds, a pledge is created by registration or entry in the pledge section of the pledgee's account, in addition to the execution of the granting contract. A security assignment is created by registration or entry in the holding section of the assignee's account, in addition to the execution of the granting contract. Although the method of perfection for a pledge or security assignment is not explicit in the Transfer Act, registration or entry (*see above*) constitutes perfection.

- **Trust beneficial interest.** Where trust beneficial interest certificates are issued, a pledge over a trust beneficial interest is created and perfected by delivery of the certificates, in addition to the execution of the granting contract (*new Article 520-7 (pre-amendment, Article 363), Civil Code, Article 194, Trust Act (Shintaku-hou)*).

Where trust beneficial interest certificates are not issued, a pledge over a trust beneficial interest is created by the granting contract and perfected by giving notice from the assignor to, or obtaining an acknowledgement from, each trustee (new Article 467, Civil Code). A trustee can prohibit creation of a pledge on the trust beneficial interest by creating a special provision within the trust contract (Article 96.2, Trust Act). The affect of this will be changed after the amendment to the Civil Code (*see Question 1*).

Claims and receivables

5. What are the most common types of claims and receivables over which security is granted in your jurisdiction? What are the most common forms of security granted over claims and receivables? How are they created and perfected?

Claims and receivables

Security is more commonly granted over:

- Loan claims.
- Rights under contracts, such as:
 - lease receivables;

- claims for fees; and
- trade receivables.

Common forms of security

The most common forms of security granted over claims and receivables are security assignments and pledges.

Formalities

The following formalities apply:

- **Security assignments.** A security assignment of claims is created by a granting contract (not necessarily in writing). Perfection against the parties with the legal obligation under the claims (obligors) is achieved by giving notice from the assignor to, or obtaining an acknowledgement from, each obligor. Using an instrument bearing a fixed date (certified date) for these notices or acknowledgments also achieves perfection against third parties (other than the obligors).
- **Pledges.** After the amendment to the Civil Code, a pledge over securities (*sashizu-shoken*) is created by a granting contract. However, creating a pledge over securities requires delivery of the securities, in addition to the execution of the granting contract (*new Article 520-7, Civil Code*).

After the amendment to the Civil Code, a pledge over claims excluding securities will be perfected in the same way as security assignments of claims (*Articles 364 and 467, Civil Code*) (*see above*).

Both a security assignment and a pledge over claims can also be perfected against third parties other than debtors of the claims by registration at the Tokyo Legal Affairs Bureau, if the assignor of the claims is a corporation (*Articles 4.1 and 14, Perfection Act*).

Cash deposits

6. What are the most common forms of security over cash deposits? How are they created and perfected?

Formalities

Under Japanese law, cash is not recognised as an asset that can be the subject of a security.

While security can be granted over a bank deposit, that security takes the form of a security over a contractual claim against the bank with which the deposit account is opened and not a security over the cash itself (*see Question 5*).

Intellectual property

7. What are the most common types of intellectual property over which security is granted in your jurisdiction? What are the most common forms of security granted over intellectual property? How are they created and perfected?

Intellectual property

It is not common for security to be granted over intellectual property in Japan. However, it is possible to use patents, trademarks and copyrights as collateral for a security.

Common forms of security

The most common forms of security interests over intellectual property are pledges and security assignments. Security assignments are probably more practical, because the registration fees for pledges can be much greater (*see Question 29, [Registration fees](#)*).

The following rights cannot be pledged (*Article 33.2, Patent Act (Tokkyo-hou); Article 13.2, Trade Mark Act (Shouhyou-hou); and Article 15.2, Design Act (Isho-hou)*):

- The right to obtain a patent.
- Rights deriving from an application for a trade mark registration.
- Rights deriving from a design registration.

Formalities

The following formalities apply:

- **Pledges.** A pledge over rights to patents, trade marks and designs is created and perfected by the execution of a granting contract and the registration of a pledge in the relevant register (*Article 98.1.3, Patent Act; Article 34.4, Trade Mark Act; and Article 35.3, Design Act*), while a pledge over copyrights is created by the execution of a granting contract and perfected by register (*Article 77.2, Copyright Act (Chosaku-ken-hou)*).
- **Security assignments.** A security assignment of rights in patents, trade marks and designs is created and perfected by the execution of a granting contract and the registration of an assignment in the relevant register (*Article 98.1.1, Patent Act; Article 35, Trade Mark Act; and Article 36, Design Act*), while a security assignment of copyrights is created by the execution of a granting contract and perfected by register (*Articles 61.1 and 77.1, Copyright Act*).

Problem assets

8. Are there types of assets over which security cannot be granted or can only be granted with difficulty? Which assets are difficult or problematic when security is granted over them?

Future assets

The Supreme Court has ruled that a transfer of future claims is allowed, if the parties both:

- Specifically identify the claims through, for example, the cause and time of accrual of the claims or their amounts.
- Clearly provide the period for either:
 - the commencement and expiration of the claim accrual; or
 - the payment of the subject claims.

The Supreme Court also ruled that the low likelihood of accrual of a claim does not, in itself, make a transfer of the future claim invalid (*Supreme Court judgment of 29 January 1999*). However, the Court also implied that it may deny all or part of the validity and/or effect of a security interest over future claims as being against public policy, if there is a special reason. This can include:

- If the granting contract effectively restricts the obligor's business activities in a manner that materially deviates from the socially accepted standard (for example, if the relevant period is too long).
- If the transfer would unjustly disadvantage other creditors.

The Amended Civil Code will clearly stipulate that future claims can be transferred and perfected in the same manner as current claims.

It is generally considered possible to create a pledge or security assignment for future claims under the same conditions as for transfers (*see above*). In practice, there may be difficulty in matters such as specifying future claims. The method of perfection is the same as for a pledge or a security assignment of accrued claims (*see Question 5, Formalities*).

Fungible assets

A security assignment can be granted and perfected over a pool of movable properties (*see Question 3, Formalities*).

It is possible to grant a security assignment over a pool of current and future claims, if the subject claims are specified (*see above, Future assets*).

Other assets

There are some assets over which the creation of security is legally and explicitly prohibited, for example:

- The rights to receive pensions, with exceptions (*Article 24, National Pension Act (Kokumin-nenkin-hou)*).

- National health insurance (*Article 67, National Health Insurance Act (Kokumin-kenkou-hoken-hou)*).

Security interests over non-transferable assets are incapable of being enforced. These assets are:

- Assets which are by their nature non-transferable (for example, a claim the performance of which is inherently only possible, if provided to a specific creditor, such as a claim against a painter to paint a portrait of the creditor) (*Articles 343 and 466.1, Civil Code*).
- Assets the transfer or disposition of which is legally prohibited, for example the:
 - right to receive public assistance (*Article 59, Public Assistance Act (Seikatsu-hogo-hou)*); and
 - right to receive wages (*Article 24, Labour Standards Act (Roudou-kihon-hou)*).
- Claims for which the parties agree to prohibit the transfer or disposition by contract (*Article 466, Civil Code*). However, this rule will be removed by the Amended Civil Code, although there is a new rule that the debtor can refuse to pay the assignee when the parties agree to prohibit the transfer or disposition by contract and there is intention or gross negligence of the assignee.

Cash

See [Question 6](#). To validly create a security interest over a bank deposit, prior consent is required from the bank with which the deposit account is opened. However, it is usually quite difficult to obtain this consent.

Release of security over assets

9. How are common forms of security released? Are any formalities required?

With the exception of an umbrella security (*see below*), security is automatically released on the full discharge of the secured obligations. If the security has been perfected using registration, release registration is also required to perfect the release.

If a secured obligation is not fully discharged, the relevant parties can agree to release the security in a written or verbal contract. In the case of a security perfected using registration, the parties would usually also agree to register the release of the asset to perfect its release.

In the case of an umbrella security, since the secured obligations are not specified, the security is usually not released until the parties agree to release it.

Special purpose vehicles (SPVs) in secured lending

10. Is it common in your jurisdiction to take security over the shares of an SPV set up to hold certain of the borrower's assets, rather than to take direct security over those assets?

Assets whose purchase is financed by the limited- or non-recourse loan are, except in exceptional cases, always taken in security. Whether or not to also take security over the shares of an SPV set up to hold certain of the debtor's assets is up to the lender. In fact, a considerable number of lenders prefer not to, because they may be reluctant to enforce the security over the SPV's share and to hold the SPV as a subsidiary which had failed to repay its debt.

Quasi-security

11. What types of quasi-security structures are common in your jurisdiction? Is there a risk of such structures being recharacterised as a security interest?

Sale and leaseback

Sale and leaseback transactions have long been extensively used, due to the advantages of the off-balance sheet treatment of assets, the possible enhancement in terms of the liquidity of fixed assets, and so on. Assets for which sale and leaseback structures have been commonly used include:

- Aircraft.
- A company's self-owned office buildings.
- Machines and facilities.
- Medical equipment.

There is a risk of recharacterisation as a secured lending transaction if the seller is deemed to retain authority or control rights which differ from the rights typically held under an ordinary transfer, for example, where the transaction terms of a leaseback:

- Substantially deviate from the typical terms of leases.

- Are not at arm's-length.

If a sale and leaseback transaction is considered to be a secured lending transaction it is treated as such by insolvency laws, among others (see [Question 24](#)).

Factoring

Factoring has been used for a long time. Under factoring transactions, clients sell their receivables to factors; in that way, the clients can hedge the risk of the obligors defaulting and the factors will receive the factoring fee (which is the balance from deducting the purchase price of the receivables from the collection amounts from the obligors). There is a risk that factoring will be viewed as a secured loan if, for example, the transaction has a structure where the client:

- Repays the factor the amount equivalent to the sales price of the claim purchased from the factor.
- Owes an obligation to repurchase the claim on default of the customer.

Hire purchase

Hire purchase is widely used in the sale of consumer products (such as cameras, sewing machines and automobiles). The seller usually retains the ownership of the subject matter unless and until full repayment is achieved. Because the terms of hire purchases typically provide a right of return on the buyer's default, hire purchases are usually treated as a type of security interest (see above, [Sale and leaseback](#)).

Retention of title

Retention of title is often used in sales of automobiles and so on. The seller retains a right to terminate the sale agreement and demand return of the subject matter, based on the title retained, in cases of default by the buyer. Retention of title is regarded as a security interest for the same reasons as hire purchase (see above, [Hire purchase](#)).

Other structures

Other structures include:

- **Repurchase arrangements ([Article 579, Civil Code](#)).** These are repurchase agreements for real estate, under which the seller can cancel the sale by refunding the purchase money (after the amendment to the Civil Code, the parties can decide the amount of refunding by agreement) and buyer's costs in connection with the sale. They are entered into simultaneously with the initial sale and purchase agreement. Under the Civil Code, asset classes other than real estate can also be subject to a repurchase arrangement.
- **Finance leases and trusts.** Other secured transactions include finance leases and trusts for security purposes.

These are also generally deemed security interest arrangements (see above, [Sale and leaseback](#)).

Guarantees

12. Are guarantees commonly used in your jurisdiction? How are they created?

Guarantees are commonly used in commercial transactions; for example, guarantees are often provided by a representative director (*daihyotorishimariyaku*), or majority owner, of a small or medium-sized enterprise when the enterprise is granted a loan.

A guarantee is only legal, binding and enforceable when an agreement is made in writing (or in electromagnetic record) between a creditor and a guarantor (*Article 446.2 to 446.3, Civil Code*). In addition, some additional rules will be incorporated into the Civil Code for the protection of individual guarantors by the contemplated amendment of the Civil Code such as:

- A revolving guarantee mainly for loans for a business is valid only when the guarantor is a certain related party of the business specified in the Article or if the guarantor expressly guarantees by a notarised deed within one month before signing the guarantee agreement.
- A debtor will be under statutory obligations to provide information and/or explanation, to the guarantor, regarding certain matters, such as the:
 - economic condition of the debtor;
 - amount to be repaid in terms of the debt;
 - occurrence of an event of default.
- Expansion of the restriction for revolving guarantees by individuals.

(see [Question 13](#) for more details).

Risk areas for lenders

13. Do any laws affect the validity of a loan, security or guarantee (or the terms on which they are made or agreed)?

Financial assistance

There are no financial assistance rules under the Companies Act. However, there are restrictions on the process and permitted acquisitions of treasury shares. A subsidiary company's acquisition of a parent company's shares is also prohibited, subject to very limited exceptions (*Article 135, Companies Act*).

Corporate benefit

The granting of a security by a subsidiary in connection with a loan extended (whether or not by a third party) to its parent would not violate the Companies Act (with limited exceptions), and there is no provision in the Companies Act concerning corporate benefit rules. However, if a subsidiary's director provides a security to the creditor of its parent, with no benefit to the subsidiary in return, he may be in breach of his prudent manager's duties and liable for damages to the subsidiary.

Loans to directors

If a joint stock company (*kabushiki-kaisha*) (that is, a company which raises funds by issuing shares, distributes profits to shareholders and the management of which is conducted by directors or corporate officers given authority by shareholders), intends to carry out a transaction with a person, other than a director, which results in a conflict of interest between the company and the director (conflict case), the director must disclose the facts material to the transaction at a shareholders' or a board of directors' meeting, and obtain the approval of either meeting (*Companies Act*). The transaction will be invalid without this approval.

The Supreme Court has ruled that if a company (A) guarantees the debt of another company (B), whose representative director is A's director, this falls within the conflict case.

Usury

If the interest rate of a loan exceeds the maximum rate permissible, the amount in excess is void. The maximum rate depends on the amount of the loan's principal (*Article 1, Interest Rate Restriction Act*):

- Less than JPY100,000: 20% a year.
- JPY100,000 or more and less than JPY1 million: 18% a year.
- JPY1 million or more: 15% a year.

If an interest payment exceeding the maximum limit is made, the portion in excess will automatically be deemed applied to reduce the principal (*Supreme Court judgment, 18 November 1964*). If this results in the outstanding principal amount being fully repaid, then any additional payments will constitute unjust enrichment and any person that receives them must refund those payments to the paying party (*Supreme Court judgment, 13 November 1968*).

Others

In Japan, some laws restrict foreign citizens having shares in certain companies, for example, foreign investors are not allowed to own more than a certain number of voting shares in broadcasting companies, airline companies or Nippon Telegraph and Telephone Corporation (NTT). Foreign lenders can still be granted security interests on such shares, however, on foreclosure or enforcement of those security interests, they will not be allowed to acquire the shares themselves above the threshold ratio (*see also Question 25*).

Generally speaking, tax regulations do not affect the ability to take collateral. However, tax regulations sometimes in practice dictate types of security. For example, the registration tax for pledges over intellectual properties is much

higher than that for security assignments over intellectual property. Therefore, there are not so many pledges on intellectual property in Japan. See also [Question 29](#).

Special rules apply to a "contract for revolving guarantee on loans" (*kashikintounehoshokeiyaku*). However, under the Amended Civil Code, this rule will be applied not only to loan obligations but all other obligations. This is defined as a guarantee agreement that includes:

- Unidentified (but described in terms of categories) debts and/or obligations as guaranteed claims.
- Within its guaranteed claims, the debts resulting from loans or discounting of bills.

When that contract has an individual as the guarantor, it is invalid if no maximum amount (*kyokudogaku*) is expressly described and stipulated within the guaranteed agreement (*paragraph 2, Article 465-2, Civil Code*). An oral agreement regarding maximum amounts is not sufficient; it must be made in writing (or electromagnetic record) (*paragraph 3, Article 465-2, Civil Code*).

Certain rules apply to a guarantee agreement where the guarantor is an individual, and where the claim that is guaranteed is the right to seek reimbursement from a guarantor (in this case a legal person) against a principal obligor under a contract for revolving guarantee on loans. This guarantee agreement is deemed to be ineffective in certain circumstances, including:

- Where the maximum amount or the fixed date (*ganponkakutei bi*) under the contract for revolving guarantee on loans is not provided.
- Where the provision regarding the fixed date or any change under the contract for revolving guarantee on loans would not be valid.

14. Can a lender be liable under environmental laws for the actions of a borrower, security provider or guarantor?

Soil Contamination Countermeasures Act (*Dojyo-osen-taisaku-hou*) (SCCA) is the main environmental law concerning land. The SCCA imposes investigation and reporting duties on the owner, manager, or occupier (extended owner) of the following land (*Articles 3 and 4, SCCA*):

- A site which was, in the past, used as a plant or workplace pertaining to a Specified Facility Using a Hazardous Substance (defined in the SCCA).
- Land, which the competent prefectural governor considers meets the criteria (set out by the Ordinance of the Ministry of the Environment) for categories of land which may be contaminated by a Designated Hazardous Substance (defined by the SCCA), where a notification under paragraph 1, Article 4 of the SCCA has been filed.
- Land, which the competent prefectural governor considers meets the criteria (set out by the Cabinet Order) for categories of land that involve a threat of harmful effects on human health due to soil contamination by any Designated Hazardous Substance (defined in the SCCA). If, as a result of a soil contamination

investigation, the contaminated status of that land's soil by a Designated Hazardous Substance does not meet the criteria prescribed in an Ordinance of the Ministry of the Environment, a prefectural governor can order an extended owner to (*Article 7.1, SCCA*):

- remove pollution;
- prevent dispersion of pollution; or
- take any other necessary measure (action for removal).

A current extended owner must fulfil the duties, even if it is not responsible for causing the pollution. However, the duty is imposed on the actual polluter, as opposed to the extended owner, if all of the following requirements are met (*the proviso to Article 7.1, SCCA*):

- It is obvious that a person other than the extended owner has caused the pollution.
- It is appropriate to impose a duty on that person to take action for removal.
- The extended owner does not object to such action.

A person who merely holds loan claims or a claim for performance of a guarantee and who is not an owner, manager or possessor of the land, would not be included in the definition of an "extended owner". There may be a risk (if the SCCA is strictly applied to a security interest over land) of the above duties being imposed on secured creditors, even if they are not responsible for causing the pollution. However, a temporary owner (for example, an owner through a foreclosure of a security interest) would only be ordered (if at all), to examine the water quality, and ensure no one enters the site, and would not be ordered to take an action for removal (*see above*) (*Article 42, Enforcement Regulation of the SCCA*).

Structuring the priority of debts

15. What methods of subordination are there?

Contractual subordination

In terms of contractual subordination, there are two types of subordination clause:

- **Absolute subordination clause (*zettaiteki-retsugo-tokuyaku*).** This is a contractual term under which a creditor agrees that its claims are subordinate to all claims of other creditors, except those holding the same kind of claims as the subordinated creditor. It is often used to enhance the capital adequacy ratio of financial institutions or the solvency margin of insurance companies.

Claims subject to an absolute subordination clause are recognised in insolvency procedures as a contractually subordinated bankruptcy claim (*yakujo-restugo-hasan-saiken*) (*Article 99.2, Bankruptcy*

Act (Hasan-hou); Article 43.4, Corporate Reorganisation Act (Kaisha-kousei-hou); and Article 35.4, Civil Rehabilitation Act (Minji-saisei-hou)) (see [Question 24](#)).

- **Relative subordination clause (*soutaiteki-retsugo-tokuyaku*).** This is a contractual term under which a creditor agrees that its claims are subordinate to claims of certain creditors specified by the clause. It is often used in structured finance to create a senior-junior tranche concerning distributions from cash flow generated by securitised assets. This relative subordination clause is often included in:
 - inter-creditor agreements for syndicated loans;
 - waterfall provisions under trust agreements;
 - conditions of bonds in securitisations.

However, there is no binding precedent on whether distributions will be made in full accordance with the clause in a bankruptcy procedure (see [Question 24](#)).

Structural subordination

Structural subordination is usually achieved by adopting different levels of a group structure. Under this method, a subsidiary is created by a reverse merger (*kaishabunkatsu*) (or otherwise) and becomes the borrower/debtor of senior debts in the structural subordination arrangements. However, it is not common to adopt a structural subordination for the purposes of corporate financing.

Inter-creditor arrangements

Inter-creditor arrangements are usually used in connection with:

- Syndicated loans.
- Commercial or residential real estate financing.
- Project financing.
- Other large loans.

The usual parties to an inter-creditor agreement are:

- The borrower.
- All relevant lenders.
- The arranger, who would typically function as the security agent, payment agent or other agency.

Although a security trustee structure is now permissible under Japanese law, it is rarely used (see [Question 18](#)).

The loan document for a syndicated loan usually provides that lenders can only take action through one of the lenders, who acts as the security agent. Therefore, in an inter-creditor agreement, only the security agent is authorised to:

- Give notice.
- Make a claim against the borrower.

See also [Question 17](#).

A typical inter-creditor agreement would include provisions relating to:

- Subordination.
- Order of payments.
- Enforcement of rights.
- Foreclosure of security.
- The agent's responsibilities, duties, rights, authorities, obligations and liabilities.

Debt trading and transfer mechanisms

16. Is debt traded in your jurisdiction and what transfer mechanisms are used? How do buyers ensure that they obtain the benefit of the security and guarantees associated with the transferred debt?

Loans from banks and other financial institutions are traded and transferred, but less frequently than in the US or some European countries.

Non-electronically recorded claims

Under general Japanese law, if a loan is transferred, any guarantees or security interests on the loan (excluding those of a revolving nature) are automatically transferred to the assignee. Guarantees (on the condition that there is a contractual provision to that regard) or security interests of a revolving nature are all of the following:

- Where the guaranteed or secured claims are not specified.
- Only the scope or types of guaranteed or secured claims is specified at the time of their creation.
- Guaranteed or secured claims will only be specified through statutory ways to specify them (when they are specified, they are referred to as being crystallised or fixed (*ganpon no kakutei*)).

The following rules apply to transferability of revolving guarantees (on the condition that there is a contractual provision to that regard) and security interests:

- Generally, a revolving guarantee or security interest cannot be transferred together with a loan secured or guaranteed by it (*see above*).
- Revolving security interests will become transferable only after the secured obligations are crystallised within the scope or types of secured claims specified at the creation of the security interest, unless the security provider approves the transfer of the revolving security interest (*Article 398-12 et seq, Civil Code*).

- Due to legal uncertainty, to transfer revolving guarantees together with guaranteed claims, it is advisable to:
 - crystallise guaranteed claims before effecting the transfer. This can be done by obtaining the guarantor's approval;
 - transfer not just guaranteed claims, but also the status of guaranteed creditors under the revolving guarantee agreement, by obtaining the consent of the guarantor.

Electronically recorded monetary claims

The parties to a transaction can now use an electronically recorded monetary claims system, which was created by the Electronically Recorded Monetary Claims Act (*Denshi Kiroku Saiken Hou*) of 1 December 2008, to grant loans as electronically recorded monetary claims. Electronically recorded monetary claims (*denshi kiroku saiken*) are monetary claims which are created and transferred through registration in electronic records prepared and kept by an electronic monetary claim recording institution. Unless the accrual record of a guaranteed claim provides that a guarantee record cannot be registered, guarantees can also be registered (and are automatically transferred with the guaranteed claims as applies under the ordinary system (*see above, Non-electronically recorded claims*)). It is not possible to register a revolving guarantee.

Agent and trust concepts

17. Is the agent concept (such as a facility agent under a syndicated loan) recognised in your jurisdiction?

Loan documents for a syndicated loan commonly provide that the lenders can only take action through one of their member lenders, who acts as agent, including giving notice and making a claim against the borrower (*see also Question 15, Inter-creditor arrangements*).

However, a loan agent cannot manage and/or collect loans or other receivables if they involve "legal affairs with respect to legal matters", unless that agent is:

- A lawyer.
- An incorporated law firm.
- A servicing company licensed under the Act on Special Measures Concerning the Business of Management and Collection of Receivables.

With no clear definition available under the statute, "legal affairs with respect to legal matters" has been interpreted widely, and includes, among others, making claims against the borrower on the behalf of creditors for the purpose of collecting receivables, which cannot be collected in an ordinary manner due to a delay in repayment by obligors and other similar reasons (*Fukuoka High Court judgment of 17 November 1961*). Therefore, facility agents that do not

fall into one of the three specified categories above, are interpreted as having very limited ability to enforce rights on behalf of other syndicate lenders in the courts of Japan.

18. Is the trust concept recognised in your jurisdiction?

The trust concept is recognised in Japan under statutes such as the Trust Act. A security trustee can claim enforcement of a security interest entrusted to it, and can receive distributions from the proceeds of the sale and other dispositions (*Article 55, Trust Act*).

Enforcement of security interests and borrower insolvency

19. What are the circumstances in which a lender can enforce its loan, guarantee or security interest? What requirements must the lender comply with?

The following events entitle a creditor (including a secured or guaranteed) creditor to seek enforcement:

- Loan receivables, or secured or guaranteed receivables have been accelerated (a declaration of default may be required by the loan agreement for this, in which case a mere event of default is not enough).
- Loan receivables, or secured or guaranteed receivables have matured (that is, the repayment dates have passed).

In an ordinary guarantee, a guarantor can require the creditor, before demanding the performance of the guarantee from the guarantor, to first:

- Demand repayment from the primary debtor (*Article 452, Civil Code*).
- Enforce against the properties of the primary debtor, if that debtor has the financial resources to pay its obligations and enforcement could easily be accomplished (*Article 453, Civil Code*).

However, joint and several guarantors cannot take advantage of these provisions.

For a creditor or a guaranteed creditor to enforce against or foreclose on a property of the debtor or the guarantor based on its rights to the loan and/or the guarantee, the creditor or the guaranteed creditor must:

- Submit a proof of obligation (*saimumeigi*), such as a duplicate copy of the court's final and conclusive judgment confirming the existence of a loan or a claim for performance of a guarantee.
- Identify the subject property or properties to the enforcement court or the enforcement officer.

A secured creditor must submit a document that proves the security interest's existence (for example, a duplicate copy of the court's final and conclusive judgment confirming the existence of the security interest) to the enforcement court or the enforcement officer, to foreclose on the secured property. However, if the secured asset is a movable property (*Articles 181.1, 189 and 193.1, Civil Execution Act*), no such document is required.

Methods of enforcement

20. How are the main types of security interest usually enforced? What requirements must a lender comply with?

There are two methods to foreclose or enforce security interests over immovable property (*Article 180, Civil Execution Act*):

- Auction of a secured asset (*Tanpo-fudousan-keibai*).
- Foreclosure by receipt of revenues from a secured asset (*Tanpo-fudousan-shueki-sikkou*), under which a court-elected administrator manages a secured asset, and revenues from the secured asset are applied to the repayment of the secured obligation.

Enforcement of security interests over movable property is made through a specific auction procedure for movable property (*Article 190, Civil Execution Act*).

The enforcement of security interests over receivables and other assets is made through a collection from the obligor of the receivables. Many of the Civil Execution Act provisions regarding compulsory executions against receivables and other assets are applied (*Articles 143 to 167 (excluding 146.2, 152 and 153), Civil Execution Act*), with all necessary changes (*Article 193.2, Civil Execution Act*).

In practice, an auction process supervised by a court generally results in a heavily discounted sale price (in some cases more than 40% below the market value of the secured asset). To secure a higher price, interested parties usually all consent to a voluntary sale instead.

Generally, pledges and security assignments in commercial transactions are allowed by law to let the creditor enforce its security interest out of court (*Article 515 Commercial Code (Shou-hou)*). That is, Japanese law grants the creditor (in the case of commercial transactions) a right to enforce the security interest simply by retaining ownership of the collateral or by proceeding with a private (out of court) auction.

Rescue, reorganisation and insolvency

21. Are company rescue or reorganisation procedures (outside of insolvency proceedings) available in your jurisdiction? How do they affect a lender's rights to enforce its loan, guarantee or security?

Private liquidation

Separate from insolvency proceedings, business entities often use a private liquidation procedure (*nini-seiritetsuzuki* or *shiteki-seiritetsuzuki*). The procedure starts when all interested creditors have agreed to it, and it is usually initiated by the insolvent debtor's lawyer. Under this procedure, the debtor company is liquidated and dissolved, and prioritised payments are made to satisfy tax claims and superior obligations claims or preferred bankruptcy claims (see [Question 24](#)). The remaining assets are distributed among the general creditors. As the procedure is voluntary and non-statutory, it is not mandatory for a creditor to consent to or accept it.

As a private liquidation procedure is not court supervised, it has no effect on a creditor's rights to enforce its loan, guarantees or security interests, unless the creditor voluntarily agrees otherwise.

Procedures

Although generally viewed as types of insolvency proceedings, two statutory non-liquidating, reorganisation-type proceedings can be used:

- **Civil rehabilitation proceedings (*Minji-saisei-tetsuzuki*).** These proceedings are based on the Civil Rehabilitation Act, and are available to all types of debtors regardless of corporate form (including Japanese Real Estate Investment Trusts (J-REITs) and individuals).

The aim of the proceedings is to rehabilitate the debtor while reorganizing its business operations. The debtor's management can continue to run its operations and manage or dispose of assets. However, in practice the competent court appoints a supervisor or supervisors (*kantoku-iin*) because there is a risk that, by offering an opportunity to the debtor-in-possession to rejoin the business community, the creditors' lawful rights to receive payments from the rehabilitating debtor may be sacrificed (*Article 54.1, Civil Rehabilitation Act*).

The debtor or a creditor can petition the court for rehabilitation proceedings. The court will order the start of the rehabilitation proceedings (*Article 33, Civil Rehabilitation Act*), provided that:

- there are sufficient grounds to start the proceedings (*Article 21, Civil Rehabilitation Act*); and
- there are no grounds to dismiss the petition (*Article 25, Civil Rehabilitation Act*).

Any of the following are grounds for starting the proceedings:

- the debtor's inability to pay its debts as they become due;
- the debtor incurring excessive liabilities; or
- the debtor's inability to pay its debts as they become due without materially endangering its continued business operation (only the debtor can petition the court to start the proceedings on this ground).

The debtor initially prepares the proposed rehabilitation plan. It is approved when both of the following are secured (*Article 172-3.1, Civil Rehabilitation Act*):

- the consent of the majority of creditors, in terms of head-count, holding voting rights limited to those who attended the meeting or voted by submissions of ballot papers; and
- the consent of at least half of the aggregate amount of the claims of the creditors who hold voting rights.

When the creditors have approved the proposed rehabilitation plan, the court must decide whether or not to allow the plan (*Article 174, Civil Rehabilitation Act*). The rehabilitation plan becomes effective when the permitting court order becomes final and binding (*Article 176, Civil Rehabilitation Act*).

- **Corporate reorganisation proceedings.** These proceedings (*kaisha-kousei-tetsuzuki*) are based on the Corporate Reorganisation Act. They are only available to joint stock companies and, in most cases, are strictly supervised by the court. The supervising court usually appoints a reorganisation trustee (*kanzai-nin*).

An eligible party can petition the court; eligible parties are the debtor, creditors or shareholders satisfying certain thresholds (*Article 17.2, Corporate Reorganisation Act*). The court will order the start of reorganization proceedings if:

- there are sufficient grounds to start the proceedings (*Article 17.1, Corporate Reorganisation Act*); and
- there are no grounds for dismissing the petition (*Articles 41.1.1 and 41.1.2, Corporate Reorganisation Act*).

The grounds for starting the proceedings are similar to those for civil rehabilitation proceedings (*see above*).

If a resolution of each class of the creditors' meetings (statute sets out the voting rights for these), approves a proposed reorganization plan (*Article 168.1 or Article 196.2, Corporate Reorganisation Act*), the court then decides whether or not to allow the plan (*Article 199.1, Corporate Reorganisation Act*). If some of the creditor class(es) do not approve the plan, the court can permit the plan by including clauses that substantially protect the dissenting creditor(s) (*Article 200.1, Corporate Reorganisation Act*).

The reorganization plan becomes effective when the permitting order becomes final and binding (*Article 201, Corporate Reorganisation Act*).

The insolvency of the primary debtor does not generally affect claims against a guarantor, or against a security provider, to enforce a guaranteed or secured creditors' interest (unless the primary debtor is also the security provider) (*Article 177.2, Civil Rehabilitation Act and Article 203.2, Corporate Reorganisation Act*).

On the other hand, a creditor can be affected if the guarantor or the security provider becomes insolvent. In that case, a claim for repayment of a loan or performance of a guarantee generated from a cause that occurred before the start of the statutory procedures cannot be enforced outside of the statutory procedures and can be paid only in accordance with the relevant plan (*Articles 84.1, 85, 154, 177, Civil Rehabilitation Act and Articles 2.8, 47, 167, 203, Corporate Reorganisation Act*).

However, this does not apply to security interests in civil rehabilitation proceedings. This is because they are treated as rights to exclusive enforcement (*betsujo-ken*), which can be exercised outside the civil rehabilitation proceedings (*Article 53, Civil Rehabilitation Act*).

By contrast, in corporate reorganisation proceedings, generally, no secured party is allowed to either:

- Exercise its security interests following the start of the corporate reorganisation proceedings (*Article 50.1, Corporate Reorganisation Act*).
- Receive payments outside the reorganisation plan (*Article 47.1, Corporate Reorganisation Act*).

However, if it is apparent that the secured asset is not necessary for the reorganisation of the debtor's business, the court can terminate the prohibition on enforcement of the relevant security interest (*Article 50.7, Corporate Reorganisation Act*).

In both civil rehabilitation and corporate reorganisation proceedings, the court can extinguish the relevant security interest, if the secured asset is indispensable for continuation of the rehabilitation or reorganisation of the debtor's business (*Article 148 et seq, Civil Rehabilitation Act*, and *Article 104, Corporate Reorganisation Act*). In this case, the secured creditor is entitled to distributions from the sale proceeds in exchange for the extinguishment (*Article 153.1, Civil Rehabilitation Act*, and *Article 110, Corporate Reorganisation Act*).

Finally, a right to avoid the creation and/or perfection of a security interest may be available to the debtor, reorganisation trustee, and so on (see [Question 23](#)).

22. How does the start of insolvency procedures affect a lender's rights to enforce its loan, guarantee or security?

Statutory reorganisation procedures

See [Question 21, Procedures](#).

Bankruptcy proceedings (*hasan-tetsuzuki*)

As in statutory reorganisation procedures:

- The insolvency of the primary debtor is not relevant to the enforcement of the guarantee or security interest unless the primary debtor is itself the security provider (*Article 253.2, Bankruptcy Act*).
- Where the debtor or guarantor is insolvent, loan claims and claims for performance of guarantees generated from a cause which occurred before the start of bankruptcy cannot be enforced outside of the proceedings and can be paid only in accordance with bankruptcy procedures and from the bankruptcy estate (*Articles 2.5 and 193.1, Bankruptcy Act*).

However, secured creditors can enforce security interests outside the proceedings even after the start of the proceedings (*Article 65, Bankruptcy Act*), subject to the following:

- **Avoidance system.** See [Question 23](#).

- **Extinguishment (termination) of security interests.** If a bankruptcy administrator (*hasan-kanzai-nin*) claims extinguishment of a security interest and the court approves this for the common interest of bankruptcy creditors, the administrator can sell the secured asset at its discretion and extinguish the security interest (*Article 186, Bankruptcy Act*).

If the secured party objects to the termination of the security interest, it can petition the court to enforce its interest, or offer to buy the secured asset. Even if the secured asset is sold by the administrator, the secured party is entitled to receive distributions from the sale proceeds (*Articles 186, 187, 188 and 191, Bankruptcy Act*).

23. What transactions involving loans, guarantees, or security interests can be made void if the borrower, guarantor or security provider becomes insolvent?

The following actions, among others, of an insolvent entity (insolvent debtor's actions) can be made void under the avoidance system (*Article 160 et seq, Bankruptcy Act; Article 86 et seq, Corporate Reorganisation Act; and Article 127 et seq, Civil Rehabilitation Act*) (see [Question 22, Statutory reorganisation procedures](#) and [Bankruptcy proceedings \(hasan-tetsuzuki\)](#)):

- Payment of its monetary obligations or performance of other obligations (including repayment of its debt and performance of its guarantee obligation).
- Granting of a security and/or perfection of that security.

Insolvent debtor's actions can be avoided in any of the following cases (*Article 162, Bankruptcy Act*):

- They took place after the insolvent debtor became unable to pay its debts as they became due, provided the creditor knew, at the time of the action, that the insolvent debtor:
 - had become unable to pay its debts as they became due; or
 - was not generally paying its debts as they became due.
- They took place after a petition had been made for the start of the insolvency procedure (provided the creditor knew, at the time of the Action, that the petition had been made).
- They took place either:
 - without there being an obligation on the part of the insolvent borrower; or
 - based on an obligation of the insolvent borrower that had not become due by the time of the grant, which was conducted within 30 days before the insolvent debtor had become unable to pay its debts as they became due.

This does not apply if the creditor did not know, at the time of the grant, that it would prejudice other creditors.

Perfection of a security interest after suspension of payments or an insolvency petition is lost if both:

- Perfection is not made within 15 days after the security interest is granted.
- The claim for avoidance is accepted by the court (*see, for example, Article 164, Bankruptcy Act*).

24. In what order are creditors paid on the borrower's insolvency?

The main categories of rights in bankruptcy proceedings to receive payments from the bankruptcy estate are:

- **Right to exclusive enforcement (*betsujyo-ken*).** A right to enforce, outside of the bankruptcy proceedings, a security interest over a specific asset that is otherwise a part of the bankruptcy estate (*Articles 2.9 and 65, Bankruptcy Act*).
- **Superior obligations claims (*zaidan-saiken*).** A claim to receive payments from the bankruptcy estate outside of the bankruptcy proceedings, with priority over general bankruptcy claims (*Articles 2.7 and 151, Bankruptcy Act*).
- **Bankruptcy claims (*hasan-saiken*).** An unsecured claim arising from a cause that took place before the start of the bankruptcy proceedings, and that is not a superior obligation claim (*Article 2.5, Bankruptcy Act*). Bankruptcy claims are unsecured creditors' claims and are further divided, in terms of the order of priority, into:
 - preferred bankruptcy claims (*yuusenteki-hasan-saiken*);
 - general bankruptcy claims (*ippan-hasan-saiken*);
 - subordinated bankruptcy claims (*retsugoteki-hasan-saiken*), including subordinated creditor claims; and
 - contractually subordinated bankruptcy claims (*yakujyo-retugo-hasan-saiken*), which rank the lowest of all bankruptcy claims.

The rules of priority of bankruptcy claims are set out in detail in Articles 97 to 99 of the Bankruptcy Act.

The following are the statutory claims:

- **Tax and other government claims.** Tax claims and other tax collection rights (tax claim rights) are classified as superior obligations, if they both:
 - arise before the start of bankruptcy proceedings; and
 - are not past their due date, or are less than one year past their due date, at the start of bankruptcy proceedings.

Other tax claim rights are classified as preferred bankruptcy claims (*Articles 148.1.3 and 98.1, Bankruptcy Act*). If tax claim rights arising after the start of bankruptcy proceedings fall in the scope of items (2) or (4)

of Article 148.1 of the Bankruptcy Act, they are classified as superior obligations. If not, they are classified as subordinated bankruptcy claims (*Articles 148.1.2, 148.1.4, 99.1.1 and 97.4, Bankruptcy Act*).

- **Bankruptcy proceedings costs and expenses.** Generally, bankruptcy proceeding expenses are considered to be superior obligations, as they are deemed to have arisen for the common interest of the creditors (*Article 148.1.1, Bankruptcy Act*).
- **Labour claims.** Salary claims of the bankrupt borrower's employees during the three months before, and the three months after the start of bankruptcy proceedings, are classified as superior obligations (*Articles 149.1, 148.1.4 and 148.1.8, Bankruptcy Act*).

Unlike reorganisation proceedings, in the case of bankruptcy proceedings (which are essentially liquidation proceedings), secured parties, including the holders of security interests considered in *Questions 2 to 6*, have rights to exclusive enforcement outside of the bankruptcy procedure. Claims that cannot be satisfied through the exclusive enforcement rights can be exercised as bankruptcy claims (*Article 108, Bankruptcy Act*).

Generally, the order of priority among holders of exclusive enforcement rights over the same secured asset is determined by the order of perfection of their respective security interests (*Articles 177, 178, 355, 373 and 467, Civil Code*). However, the order of priority for statutory liens differs depending on the statute (*Articles 329 to 340, Civil Code and other relevant statutes*).

If a security interest has not been validly perfected, the security holder is treated as an unsecured creditor. Although perfection is not necessary for a secured party to assert its security interest against the debtor, perfection is required to assert a security interest against a bankruptcy administrator or other insolvency officers. This is because the bankruptcy administrator and other insolvency officers are regarded as third parties in relation to the secured creditors.

Cross-border issues on loans

25. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders, or taking guarantees from foreign subsidiaries of the borrower?

Generally, foreign nationals or foreign companies are not prohibited from making loans, acquiring security interests, or receiving guarantees, and there is no restriction under Japanese law in relation to taking guarantees from foreign subsidiaries of the borrower. However, the following restrictions may apply:

- If the making of loans by foreign lenders falls under "money lending business" (defined as lending money or acting as an intermediary in the lending of money conducted in the course of trade) (*Article 2.1, Money Lending Business Act*), those foreign lenders must obtain money lending business registration (license).

- If a foreign bank engages in banking business including lending in Japan, that foreign bank must obtain a licence from the prime minister by specifying a single branch office that will serve as the principal base of that foreign bank's banking business in Japan.
- Some individual laws restrict acquisition of rights by foreign nationals and foreign companies (for example, *Article 116, Broadcasting Act (Housou-hou)*, *Article 120-2, Civil Aeronautics Act (Kouku-hou)* and *Article 6, Act on Nippon Telegraph and Telephone Corporation, etc. (Nihondenshindenwa-kabusikaishatou-nikansuru-houritsu)*). In that case, even if a relevant right can be made subject to a security interest (there may be cases where security assignments cannot be created), secured parties cannot acquire the secured assets through enforcement of the security above the stipulated threshold ratio of voting shares.
- There is a duty to report capital transactions or inward direct investments (*see Question 26, Duty to report*).

26. Are there exchange controls that restrict payments to a foreign lender under a security document, guarantee or loan agreement?

Duty to report

In principle, the following must be reported, retrospectively, to the Minister of Finance if they fall within the scope of a capital transaction or inward direct investment (*Articles 20 and 26, Foreign Exchange and Foreign Trade Act (Gaikoku-kawase-oyobi-gaikoku-boueki-hou) (FEFT)*):

- Execution of security documents, guarantee or loan agreements.
- The foreclosure of security.

In addition, certain payments or transfers of money, as provided in the FEFT (for example, a payment by a resident to a non-resident), also require an after-the-fact report to the Minister of Finance (through the BOJ), subject to available exemptions and exceptions (for example, a payment not exceeding JPY30 million) (*Article 55, FEFT*).

After-the-fact reporting is not required in certain circumstances, for example, for a capital transaction regarding a loan not exceeding JPY100 million between a resident and non-resident (*Article 55-3.1.2, FEFT; Article 18-5.1.1, Foreign Exchange Order; Article 5.1.1, Ministerial Ordinance concerning Reports on Foreign Exchange Transactions, etc.*).

Duty to secure consent

The Finance Minister's prior consent is required in certain circumstances, for example, where he determines that the transfer of significant funds between Japan and a foreign state, if conducted without any restrictions, will (*Article 21.2.3, FEFT*):

- Adversely affect the Japanese financial or capital market.
- Make it difficult to achieve the purpose of the FEFT.

Brexit

27. If UK financial institutions no longer have "passporting" rights in the EU after Brexit, what regulatory requirements would a UK lender have to comply with to make a loan to, or purchase a loan made to, a borrower in your jurisdiction?

Whether or not a UK financial institution has "passporting" rights in the EU after Brexit does not have any particular impact on what regulatory requirements a UK lender would have to comply with to make a loan to, or purchase a loan made to, a borrower in Japan. That is to say, under Japanese law, "passporting" rights in the EU have nothing to do with those regulatory requirements. UK financial institutions, regardless of whether or not they have "passporting" rights in the EU, are required to comply with the usual regulatory requirements (see [Question 25](#)).

28. Will a UK financial institution require a licence to lend after Brexit? Will a UK lender be able to take security from a borrower in your jurisdiction?

A UK financial institution is required to have a licence to make a loan to a borrower in Japan after Brexit (see [Question 26](#)). A UK lender is able to take security from a borrower in Japan after Brexit.

Taxes and fees on loans, guarantees and security interests

29. Are taxes or fees paid on the granting and enforcement of a loan, guarantee or security interest?

Documentary taxes

Taxes, for example, a stamp duty, are not generally imposed on mortgage agreements or related documents. Stamp duties are payable on the following types of agreement under the Stamp Tax Act (*Inshi-zei-hou*):

- Loan agreements: the amount of stamp taxes imposed differs, depending on the aggregate principal amount of the loan (*schedule 1-1-3*). Where a mortgage agreement or related documents also include provisions about the loan that is secured, stamp tax is imposed on it as if it is a loan agreement (*schedule 1-1-3*).
- Guarantee agreements, except where the agreement is contained in the relevant loan agreement: JPY200 (*schedule 1-13*).
- Agreements on assignment of receivables: JPY200 (*schedule 1-15*). This includes mortgage agreements that contain an assignment of compensation claims (for example, a claim for monetary compensation resulting from condemnation of the mortgaged properties by a government or a local public agency for the purpose of road construction or other public projects).

Registration fees

A registration and license fee (registration fee) is imposed when a registration and/or license system is used for perfection of a security, for example:

- The registration fee for a permanent registration of an immovable property mortgage or pledge is 0.4% of the claim amount that it secures (*Article 9, schedule 1-1-(5), Registration and License Tax Act (Touroku-menkyo-zei-hou)*).
- The registration fee for the creation of a pledge over receivables is JPY15,000 (*Article 9, schedule 1-9-(2), Registration and License Tax Act*), whereas the registration fee for the creation of a pledge over intellectual property such as patents, trade marks, copyrights and designs is 0.4% of the secured claim (*Article 9, schedule 1-13-(3), 1-16-(3), 1-10-(2), 1-15-(3), Registration and License Tax Act*).
- The registration fee for a transfer of right varies depending on the asset subject to the transfer. For example, the registration fees for a transfer of intellectual property are JPY15,000 for patents, JPY30,000 for trade marks, JPY18,000 for copyrights and JPY9,000 for designs (*Article 9, Schedule 1-13-(1), 1-16-(1), 1-10-(1), 1-15-(1) Registration and License Tax Act*).

No registration fee applies to the granting of a loan or a guarantee unless they are or involve electronically recorded monetary claims.

Notaries' fees

The parties can (although they are not required to) prepare a security document in the form of a notary deed for enforcement purposes, because a notary deed is one type of proof of obligation (*saimumeigi*) (see [Question 19](#)). Notary fees are set out by law (*Articles 9 and 12, Order for Notary Fees (Koushounin-tesuuryou-rei)*).

Fees for enforcement procedures

The petition fee payable to the court for the enforcement of loans, guarantees or security interests under the Civil Execution Act is JPY4,000 for every claim or security interest realised through an auction procedure (*Article 3, schedule 1-11, Act on Costs of Civil Procedure (Minji-soshou-hiyou-tou-ni-kansuru-houritsu)*).

The registration fee for registration of an attachment on a real estate resulting from foreclosure is 0.4% of the secured claim (*Article 9, schedule 1-1-(5), Registration and Licence Tax Act*).

The current enforcement fees for prepayment to the court in the Tokyo District Court are:

- For a claim below JPY20 million: JPY600,000.
- For a claim of JPY20 million or more but less than JPY50 million: JPY1 million.
- For a claim of JPY50 million or more but less than JPY100 million: JPY1.5 million.
- For a claim of JPY100 million or more: JPY2 million.

30. Are there strategies to minimise the costs of taxes and fees on the granting and enforcement of a loan, guarantee or security interest?

The real property registration system allows provisional registrations, at a lower charge than permanent registrations. For example, the registration fee for a permanent registration of a mortgage is 0.4% of the claim secured, but the provisional registration fee is only JPY1,000 per property.

However, to enforce the security interest through a court-supervised procedure it would be necessary to convert the provisional registration into a permanent registration. In that case, the permanent registration fee would be imposed in addition to the provisional registration fee.

To minimise stamp tax, it is customary for a loan agreement to be executed in a single original (with no counterpart), and the borrower to only keep a copy of the executed loan agreement.

Reform

31. Are there any proposals for reform?

The amendment of the Civil Code will be made effective on 1 April 2020. The Amended Civil Code deals with all provisions of the Civil Code relating to contracts and claims, ranging from statutes of limitation, guarantees, powers of attorney, the statutory interest rate, contractual remedies for breaches including terminations and rescissions, transfers of claims/receivables and set-offs to provisions on certain types of contracts (loans, leases, sales and purchases, sub-contracts and partnerships, etc.). This is the first fundamental amendment to these provisions since the Civil Code's enactment in 1896.

In relation to financial transactions, the Amended Civil Code includes some important amendments, including the:

- Amendment of the public interest rate from a fixed rate to a floating rate.

- Reinforcement of the protection of individual guarantors.
- Amendment of the period of statute of limitation.
- Amendment with respect to transfer of claims.

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