COMMENT

TRANSPLANTING ASSET SECURITIZATION: IS THE GRASS GREEN ENOUGH ON THE OTHER SIDE?*

“Curiouser and curiouser . . . .”
Lewis Carroll, Alice in Wonderland

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This Comment examines the “exportability” of asset securitization, one of the more important financing vehicles in the United States. The issue presented here is whether the mechanics of this rapidly expanding financing technique will operate with the same success if transplanted into a different legal and economic environment.

Many factors go into making securitization successful in the United States. These factors can be divided conceptually into legal (structural) factors and economic (market) factors. Will this technique function as successfully in environments where some of these factors are absent or function differently? This Comment argues that the deficiencies related to economic factors may not make the transaction per se impossible, but will contribute to the overall financing cost, necessitating a cost-benefit analysis. However, deficiencies in legal infrastructure can serve as a complete transactional bar.

Cross-border securitization transactions are those in which: (i) the company originating the asset is in one country; (ii) a trust or other special purpose entity in another country purchases the originator’s receivables; (iii) the payors on the receivables are outside the originator’s country; (iv) the receivables are largely denominated in the same currency as the securities; and (v) the trust receives payments directly from the payors and makes distributions directly to investors. Most cross-border/transnational securitizations are structured using the U.S. model. This should come as no surprise, because the United States presents, by far, the largest securitization market in the world.¹ The United States was first in developing this financing technique on a large scale,² but it is not the only country in the

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1. Fidelis Oditah, Great Britain, in ASSET-BACKED SECURITIZATION IN EUROPE 99–100 (Theodor Baums & Eddy Wymeersch eds., 1996) (concluding that while the U.K. securitization market is the most mature in Europe, it is still far behind the dynamic growth of the United States).
2. See Joseph C. Shenker & Anthony J. Colletta, Asset Securitization: Evolution,
world with an established securitization market and a developed financial infrastructure. However, the countries that present the most opportunities, and may benefit the most from securitization, typically do not have these important structures in place.

The analytical framework for transnational securitization presented here may interest both comparative law scholars and practitioners whose clients want to venture into the less-explored realm of alternative financing vehicles in cross-border transactions. This framework may prove useful for identifying legal and economic factors that may present potential problems during transnational securitization. Likewise, it may be useful in conducting a realistic transaction assessment with due consideration for such infrastructure deficiencies that may arise during very early planning stages, thus avoiding or mitigating foreseeable costs. This Comment’s goal is not to describe in detail the legal peculiarities in particular jurisdictions, but to help identify the factors vital to the transaction’s success.

A systems, or functional, approach was used in analyzing the securitization elements presented here. This approach focuses on the mechanisms and their functions within a legal system itself.

Securitization-like transactions have been taking place at least since the late nineteenth century, when mortgage-backed bonds were sold to the public, and mortgage bankers issued mortgage participation certificates similar to modern mortgage-backed securities. Id. at 1380–81. “In the 1920s, private title and mortgage insurance companies . . . sold ‘guaranteed mortgage participation certificates,’” the popularity of which ceased only with the Depression and widespread defaults on underlying mortgages in the 1930s. Id. at 1381; see also Michael H. Schill, Uniformity or Diversity: Residential Real Estate Finance Law in the 1990s and the Implications of Changing Financial Markets, 64 S. CAL. L. REV. 1261, 1263–65 (1991) (describing the secondary mortgage market growth and securitization from the 1930s to the early 1980s). The recent growth in securitizations, however, began as the result of governmental efforts to promote housing finance by developing a secondary mortgage market. Shenker & Colletta, supra, at 1383–88 (discussing economic, legal and other forces driving securitization). For examples of government efforts, see 12 U.S.C. § 1716 (1994) (stating that the purpose of the statute establishing national mortgage associations is the creation of “secondary market facilities for residential mortgages”) and S. REP. NO. 91-761, at 1 (1970), reprinted in 1970 U.S.C.C.A.N. 3488, 3489 (stating that congressional purposes in enacting the Emergency Home Finance Act of 1970 were to expand “existing mortgage credit facilities” and to create “new secondary market facilities to broaden the availability of mortgage credit”).

3. The term “financial infrastructure” is used as shorthand for the legal, regulatory, accounting, and tax systems necessary to facilitate securitization transactions. Tamar Frankel, Cross-Border Securitization: Without Law, But Not Lawless, 8 DUKE J. COMP. & INT’L L. 255, 265–66 (1998). The foundation of any comparative analysis involving the possibility of a particular finance transaction type in a foreign jurisdiction is whether the jurisdiction in question has the financial infrastructure to enable every aspect of the transaction. As will be discussed below, securitization consists of several discrete stages, necessitating such analysis for each stage.
not on legal doctrines or constructs. This Comment will attempt to establish an analytical framework based on the technique's nature, not on any particular jurisdiction's legal system. The issues discussed in this Comment apply not only to cross-border securitizations, but also to its “domestication” abroad. Many developing countries are adopting their own laws promoting securitization directly or indirectly. But the legal and tax codes, as well as insolvency and asset transfer laws, are largely untested and may prove unfavorable. One issue in such domestications remains the same: whether the country has the financial infrastructure to effectuate securitization.

Although this Comment is dedicated primarily to reviewing issues presented by a target jurisdiction’s domestic laws, successful transaction planning should also involve transnational law issues beyond this Comment’s scope. For example, a comprehensive analysis would include a determination of the effect that multilateral agreements on investment and services will have on the transaction in question.

4. Functional analysis is one of the methods of contemporary comparative law. Lynn M. LoPucki & George G. Triantis, A Systems Approach to Comparing U.S. and Canadian Reorganization of Financially Distressed Companies, 35 HARV. INT’L L.J. 267, 269–70 (1994). It focuses on explaining differences and similarities of legal rules in the context of their legal system and the function that they serve, and not the nomenclature used to describe them. Id. In particular, this method of analyzing secured transactions law was developed by Lynn LoPucki and George Triantis in the context of bankruptcy reorganization. See id. at 266–77 (using the method to focus on problems in a given area of law, bankruptcy reorganization in this case, and describing the ways in which different legal systems deal with these problems).

5. Statutes and regulations cited in this Comment are used for illustrative purposes only. There is a multitude of academic and practitioner publications comprehensively covering every securitization stage. The footnotes in this Comment contain citations to some of the more useful and informative commentaries.


8. Agreements that warrant special attention include the WTO’s General Agreement on Trade in Services (GATS), the WTO’s Agreement on Trade-Related Investment Measures (TRIM), the International Centre for the Settlement of Investment
Part I is an introduction to securitization. This Part discusses securitization’s stages, its objectives, and benefits, which attract investors worldwide, and the typical risks associated with cross-border securitizations. Part II presents the analytical framework defining the financial infrastructure and elements necessary to carry out a securitization transaction successfully. Part III analyzes the effect a deficient infrastructure may have on a transaction based on the type of deficiency.

I. INTRODUCTION TO ASSET SECURITIZATION

Modern securitization was invented in the early 1970s.9 Since then, transaction volume has exploded.10 True exportation began in the 1980s when collateralized mortgage obligations (CMO) were introduced and widely received in global markets.11 Many commentators expect that securitization will remain a significant financing source well into the future.12

A. Definition

Securitization is a financing technique whereby a company transfers rights in receivables13 or other financial assets to an

Disputes (ICSID) Convention, the Multilateral Investment Guarantee Agency (MIGA) Convention, and free trade agreements that include investment provisions, such as the United States-Canada Free Trade Agreement, Chapter 11 of the North American Free Trade Agreement (NAFTA), and various bilateral investment treaties signed by the United States (for example, the Russian Federation-United States “Treaty concerning the Encouragement and Reciprocal Protection of Investment”).

9. Refer to note 2 supra (chronicling the rise and growth of securitization in the United States during the twentieth century); see also 1 TAMAR FRANKEL, SECURITIZATION: STRUCTURED FINANCING, FINANCIAL ASSETS POOLS, AND ASSET-BACKED SECURITIES § 2.4.2 (1991) (surmising that “[t]rue securitization by pooling . . . began in the 1970s”).

10. Schill, supra note 2, at 1267 (“The size and scope of the secondary mortgage market increased in the early 1970s and surged dramatically in the 1980s.”).

11. Edward L. Pittman, Economic and Regulatory Developments Affecting Mortgage Related Securities, 64 NOTRE DAME L. REV. 497, 511–12 (1989). “Stripped” mortgage-backed securities, or collateralized mortgage obligations (CMOs), that separate the interest-only payment from the principal-only payment, were first offered by the Federal National Mortgage Association (“FNMA” or “Fannie Mae”). Id. at 511; Henry A. Fernandez, Globalization of Mortgage-Backed Securities, 1987 COLUM. BUS. L. REV. 357, 357 (discussing the importance of the CMOs in launching asset securitization worldwide).

12. Claire A. Hill, Securitization: A Low-Cost Sweetener for Lemons, 74 WASH. U. L.Q. 1061, 1062 (1996) [hereinafter Hill, Sweetener for Lemons] (stating that “securitization is expected to remain a significant source of financing in the years to come”); see also Steven L. Schwarz, The Alchemy of Asset Securitization, 1 STAN. J.L. BUS. & FIN. 133, 154 (1994) [hereinafter Schwarz, Alchemy of Securitization] (“Because securitization has only been applied to a portion of its potential market opportunities, it promises to be a financing technique that will continue to grow.”).

13. See Schwarz, Alchemy of Securitization, supra note 12, at 135 (referring to receivables as the rights to future payments such as mortgage payments on a house or
entity that serves as a “special purpose vehicle” (SPV), which in turn issues securities to capital market investors and uses the proceeds from the issue to pay for the financial assets.14

In their simplest form, asset securitizations involve a “sale” of financial assets (such as trade or consumer accounts receivable) by the firm seeking to raise capital (the “originator”) to a separate, specially created corporation or trust (usually called a special purpose vehicle or SPV). The SPV raises the purchase price of the assets by selling debt or equity interests in public markets or through private placements. This series of transactions leaves the investors with claims against the SPV, the SPV with the assets transferred by the originator, and the originator with the proceeds of the sale transaction.15

The assets can be of various natures: oil and gas,16 lease, auto loan or credit card receivables,17 commercial mortgage loans,18 equipment leases,19 state lottery winnings,20 litigation lease payments on a car, that sometimes are included as a subset of “assets”).

“Receivables can be short term (typically due in 30 days), such as trade receivables, which represent the right to payment for goods sold or services rendered, or they can be long term, such as payments due over a period of years under loans, leases, licenses, management contracts, etc.” Id. n.7 (citing STEVEN L. SCHWARCZ, STRUCTURED FINANCE, A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION 5–15 (2d ed. 1993) [hereinafter SCHWARCZ, STRUCTURED FINANCE]). Receivables increasingly have been the dominant asset category for securitization. See SCHWARCZ, STRUCTURED FINANCE, supra, at 5–7 (discussing the payment source nature and requirements).

14. SCHWARCZ, STRUCTURED FINANCE, supra note 13, at 1–3 (defining an SPV trust as an element of typical structured financing whereby a company sells some of its assets to a the trust in order to raise capital); Hill, Sweetener for Lemons, supra note 12, at 1066–68 (noting that a company, in an effort to raise capital, may sell its rights to future monies or receivables to a securities pool which, in turn, offers the pooled securities to investors in private or public offerings); Schwarz, Alchemy of Securitization, supra note 12, at 136 (describing the securitization process whereby a company uses an SPV to “raise[] funds by issuing securities—usually debt or debt-like securities—and [then uses] the receivables purchased from the originator to repay investors in the future”).


16. See Charles E. Harrell et al., Securitization of Oil, Gas, and Other Natural Resource Assets: Emerging Financing Techniques, 52 BUS. LAW. 885, 886 (1997) (describing “the securitization of domestic and international oil and gas assets, with particular attention to the securitization of future receivables tied to anticipated proceeds of production of oil or gas”).


settlement payments, and even royalties from record sales. The most significant factor in selecting asset categories suitable for securitization is that they have a predictable cash flow, because cash flow is required to service the debt or equity issued by the SPV.

Thus, the term “securitization” refers to converting highly liquid assets sold to the SPV into standardized, readily tradable instruments, insulating these securitized assets from general business risks.

B. Stages of Securitization

Conceptually, traditional domestic securitization that uses bonds as the underlying asset can be broken down into seven stages.

1. Making or acquiring debt obligations. The underwriter, upon the originator’s request, identifies attractive bonds and creates a portfolio concept, in which debt obligations with various risks are weighted in certain proportion.

2. Assigning these obligations to a specially signed entity. After the originator identifies certain highly liquid assets, the originator separates them from the risks generally associated with the originator by selling them to the special purpose vehicle (SPV).

3. Causing the entity to issue securities to investors representing claims against the entity’s assets. The SPV uses the assets transferred to it from the originator “to raise funds in the
capital markets at a lower cost” than the originator could ever achieve by issuing its own debt or equity directly.29

4. Securing credit enhancement. The SPV’s bankruptcy remoteness from the originator allows the originator to raise capital at a lower cost than if it were to issue its own securities (so-called “credit enhancement”).30 The risk reduction produced is often worth the cost paid for such credit enhancement due to lower financing cost.31

5. Seeking ratings for the entity’s securities.32
6. Creating secondary markets for the securities.33
7. Managing and servicing the assets held by the entity. After the sale, the originator usually continues to service the accounts—making collections, maintaining records, and enforcing delinquent accounts.34

C. Objectives and Benefits

There are several financing methods available to companies that need funds: (i) issuing stock; (ii) borrowing money directly from banks, institutional investors such as insurance companies, mutual funds, or pension funds, on a secured or unsecured basis; (iii) selling assets and leasing them back; and (iv) selling rights to receive future monies (sale of receivables or “factoring”).35

However, some companies may have limited options due to low credit rating, high sovereign risk,36 or other factors contributing to asset or entity risks.37 Such risks prevent a company from borrowing needed funds directly or from issuing its own debt or equity instruments at an acceptable cost.38 Asset securitization is intended to allow these companies to raise necessary funds by segregating particular assets from the business operation completely,39 rather than by selling them.40

29. Id.
30. Id. at 134, 143.
31. See id. at 143.
32. Id. at 136.
33. Frankel, supra note 3, at 255 n.1.
34. SCHWARCZ, STRUCTURED FINANCE, supra note 13, at 33–34.
35. Hill, Sweetener for Lemons, supra note 12, at 1066–67; Schwarcz, Alchemy of Securitization, supra note 12, at 144–45 (comparing factoring to securitization and describing factoring as a lower-cost financing alternative for smaller companies that cannot afford the transaction costs of securitization).
36. Refer to Part I.D infra (defining sovereign risk and other risks associated with securitization).
37. Refer to Part I.D infra (discussing asset and entity risks).
39. SCHWARCZ, STRUCTURED FINANCE, supra note 13, at 1.
Securitization brings with it multiple economic and financial benefits. In addition to allowing companies to raise funds when more conventional sources become unavailable, it permits companies—particularly those in a regulated industry—to improve their balance sheets by removing these assets from the balance sheet.\(^4\) Furthermore, the cost of capital raised through securitization is lower than if the originator were to issue its own securities, due to credit enhancement achieved through the SPV’s “bankruptcy remoteness.”\(^4\)

Additionally, securitization converts future income streams into cash, giving companies new funds to apply to opportunities with greater profit potential than what is tied up in past lending decisions. It creates markets for assets themselves, making them more liquid, more desirable and, therefore, more valuable,\(^4\) as well as revealing the value of the underlying assets.\(^4\)

Securitization also carries with it significant social benefits. It pools smaller assets into large funds and spreads risk over large consumer loan portfolios. This makes more funds available to individual borrowers whose credit ratings would otherwise disqualify them from receiving such loans. Consequently, small businesses are more competitive, and the quality of life for individual borrowers is increased.

\(^4\) Assets do get sold, but they are sold to an SPV that is usually controlled by the originator. Id. at 1–2. The originator truly gets to “have his cake and eat it too.” Namely, the originator maintains at least some control over the fate of the assets and receives financing at terms more beneficial than he could ever have achieved through issuing debt directly, selling assets to an independent third party, or pledging these assets as collateral. Id.

\(^4\) For example, by converting loan assets into cash through securitization, banks and financial institutions, which are subject to requirements that they maintain risk-based capital under capital adequacy guidelines, can remove from their books assets for which they would otherwise have to maintain capital. Steven L. Schwarcz, Structured Finance: The New Way to Securitize Assets, 11 CARDozo L. REV. 607, 608 (1990) [hereinafter Schwarz, The New Way to Securitize Assets]. This reduces their capital requirements and may enable them to extend new loans. Id.

\(^4\) See Schwarz, Alchemy of Securitization, supra note 12, at 135–36 (explaining that limitations placed on the business activities of an SPV produce “bankruptcy remoteness” status that shields the SPV from the adverse affects of originator bankruptcy and, as a result, makes the SPV more marketable to investors).

\(^4\) This is particularly relevant for assets that have low liquidity and few or no potential buyers due to their size; combining large assets for resale as smaller investments (for example, financing the construction of a large office tower through a real estate investment trust) solves the liquidity problem.

\(^4\) Public trading of asset-backed securities (ABS) establishes implied values for the underlying assets. This reveals the value of property-based loans and the underlying property itself (for example, portfolios of loans sold at ten percent of face value or less recognize both the decline of property prices and the less-than-100-percent probability of loan repayment).
Securitization may be one of the very few ways to obtain financing for many developing countries, particularly in light of the recent Asian crisis. Many Asian and European countries have raised capital through asset securitization.

D. Typical Risks Associated with Securitization Abroad.

Analytically, the risks associated with a standard securitization can be subdivided into two types: asset risks and entity risks. “Asset risks” are risks intrinsic to the future payment stream, such as the possibility that account debtors may fail to pay on time and in full. “Entity risks” are risks stemming from the borrower’s domicile and economic prospects, such as its general credit rating and the possibility the borrower will end up in bankruptcy.

Securitization’s objective is to separate these two risks. Separating the assets, by either selling them to an SPV, or by granting a first priority security interest to an SPV, allows the SPV’s creditors “to lend at an interest rate that takes into account only the risk inherent in the segregated assets.”

However, separating these two risks may not be enough in cross-border securitizations. Parties structuring securitized

45. Guarantors Jockey for Position in Asia, MORTGAGE-BACKED SEC. LETTER, Jan. 5, 1998, 1998 WL 10104071 (noting that amid the 1997 Asian economic crisis, “for many companies in Asia, securitization may [have been] the only method of raising capital”); Adam Reinebach, Japan’s Capital-Hungry Banks Look to the Growing CLO Market, INVESTMENT DEALERS’ DIG., Feb. 16, 1998, at 14, 14 [hereinafter Reinebach, Japan’s Capital-Hungry Banks] (“One method that’s become increasingly popular seems tailor-made for [the Japanese banks’ need for capital]: securitizing their commercial loans.”). Even during the 1997 Asian crisis, several securitizations took place in Japan, including securitizations of catastrophe bonds (as a substitute for reinsurance against catastrophes such as hurricanes and earthquakes), equipment leases, apartment loans, and auto loans. Adam Reinebach, Securitizing Europe: After Years of Hype About Overseas Potential, the Asset-Backed Market is Finally Going Global, INVESTMENT DEALERS’ DIG., Dec. 8, 1997, at 14, 16–17 [hereinafter Reinebach, Securitizing Europe].

46. See generally SECURITIZATION YEARBOOK 2000, supra note 17 (discussing securitization in numerous Asian and European countries including China, Japan, France and Germany).


48. True, supra note 47, at 542.

49. Id.

50. Id. (explaining that securitization seeks to divide asset risk from entity risk and eliminate entity risk).

transactions usually obtain ratings from a major credit rating agency, such as Standard & Poor’s or Moody Investor Services.\textsuperscript{52} As an industry-wide practice, credit rating agencies limit the credit rating they assign to a particular company by the credit rating of the country in which the company is located—a limitation known as the “sovereign risk ceiling.”\textsuperscript{53} In these types of transactions, it is possible—by structuring the transaction correctly—to avoid the sovereign risk ceiling and thus acquire a higher credit rating.\textsuperscript{54} This is especially meaningful to companies in high-risk countries, such as Russia, whose sovereign debt rating is well below investment grade.\textsuperscript{55}

The paradox might be that high-risk investment environments may present fertile grounds for risk securitization. Catastrophe risks, agricultural risks (associated with adverse weather conditions), project financing risks (associated with the

\textsuperscript{52} Hill, \textit{Sweetener for Lemons, supra} note 12, at 1070.

\textsuperscript{53} See Marissa C. Wesely, \textit{Securitizing Project Debt, in New Developments in Securitization} 1996, at 335, 368–69 (PLI 1996). Sovereign risk factors include:

(i) deterioration in the value of the sovereign's currency in relation to the currency in which the issuer’s debt is denominated (i.e. exchange rate risk); (ii) imposition of exchange controls or similar actions that could limit convertibility of the sovereign's currency (i.e. transfer risk); (iii) deterioration of general business and economic environment or detrimental regulatory actions; (iv) declaration of a moratorium or similar prohibition or restriction against any payments on external debt [(such as the moratorium on repayment of foreign debt announced by the Russian government following the August 1997 financial crisis)]; (v) temporary diversion of debt service payments; (vi) expropriation of the issuer or its property [(such as seizure of collateral by the government for law violation, such as tax evasion)] and repudiation of its debt; and (vii) civil unrest, including social and labor disturbances.

\textit{Id.} at 374–75.

\textsuperscript{54} \textit{Id.} at 374. For example, Garanti Leasing of Turkey obtained the above-sovereign rating by using Turkish lease receivables that were assigned in favor of the International Finance Corporation (IFC), a World Bank affiliate internationally recognized as a preferred lender, to repay a loan taken by Garanti Leasing. See Hergüner Bilgen & Özeke, \textit{Turkey, in Securitization Yearbook 2000, supra} note 17, at 64 (stating that the transaction provided comfort “that the Turkish government would not use its sovereign powers to affect payments due to the IFC . . ., [thus avoiding] exchange rate, convertibility and transfer risks”).

\textsuperscript{55} Wesely, \textit{supra} note 53, at 368–69 (noting that securitization is extremely important to companies in countries that do not receive investment grade ratings because it enables them to overcome the limitations of the “sovereign risk ceiling” and receive higher ratings than those given to the countries in which they are located). An “investment grade” security is typically considered suitable for purchase by institutions under the prudent man rule, and includes bonds rated “BBB” or higher. \textit{AIAN H. PESSIN & JOSEPH A. ROSS, WORDS OF WALL STREET} 115, 193 (1983) (defining “investment grade” and “rating”). The highest rating, “AAA,” is considered “virtually certain . . . to be timely and fully repaid in accordance with its terms.” Hill, \textit{Sweetener for Lemons, supra} note 12, at 1070–71. To avoid the risks motivating the sovereign risk ceiling, the key structural objective becomes to source the payment stream repaying the debt obligation in a jurisdiction outside the high risk country, for example, in Western Europe or the United States. See Wesely, \textit{supra} note 53, at 238.
securitization of future income not arising from an existing contract), and political risks are great candidates for securitization. However, problems may arise because these opportunities rarely present themselves in strong economies with established financial infrastructures. The following discussion is a tool for evaluating securitization opportunities in less than perfect economic and legal environments.

II. ANALYTICAL FRAMEWORK

Investors interested in securitizations in a foreign jurisdiction (cross-border securitization, transnational securitization or securitization of assets located abroad) face several concerns. The prime inquiries for such investors become the following: Which elements are missing from the target country’s financial infrastructure? Can the transaction be carried out in their absence? How would that affect the transaction’s risk level and cost?

The analytical framework developed in this Comment describes two categories of factors: legal/structural and economic. The legal/structural factors include jurisdictional issues, conflict of laws, commercial finance, business and securities laws, bankruptcy laws, tax systems, governmental regulations and restrictions, and debt collection and enforcement issues. The economic factors include rating agencies, accounting standards, multi-currency issues, and economic stability issues.

A. Legal and Structural Factors

The legal and structural factors discussed below are potentially vital for successful securitizations. Freedom to sell and exchange financial assets, non-discriminatory tax treatment, and the ability to enforce legal and equitable rights in the court system are among the most critical factors.


57. The inquiry will primarily concern investors interested in countries that do not yet have a developed securitization market. These problems are not as likely to arise in countries such as France, Germany, or Great Britain that already have developed securitization markets and tested legal frameworks that make this type of transaction possible.

58. See Frederick Feldkamp, Asset Securitization: The Alchemist’s Dream, in SECURITIZATION YEARBOOK 2000, supra note 17, at 7 (“Securitization depends on the ability of investors to freely trade financial assets/obligations, to meaningfully account for such trades, and to be assured non-discriminatory tax treatment, legally enforceable
1. Jurisdictional Issues and Conflict of Laws. “By definition, cross-border securitization is not governed by one or even two legal systems.” In choosing governing law, an investor should consider several factors that determine how accommodating a particular jurisdiction is to securitization. Factors to consider include opportunities to create an inventory of financial assets through originating, buying or selling; various risks and their levels; quality of an institutional or legal infrastructure; and optimal regulation and tax laws. Even though a transaction can take place when local laws are not satisfactory, some legal infrastructure is necessary, as it provides uniform, predictable rules of behavior.

Moreover, where each discrete stage of securitization can be performed by a separate entity, “choice of law” analysis needs to be done individually for each stage, particularly in the beginning. The final decision regarding choice of law may depend on the following balancing act:

1. which necessary infrastructure elements are present in the target jurisdiction;
2. which elements, even if absent, can be contracted around; and
3. what elements have to be present to assure the transaction success?

Because capital, the prime asset in securitization transactions, is a highly liquid and transferable commodity, parties may pick and choose the country whose law meets the transaction’s particular needs.

contractual rights and equitable treatment in bankruptcy/reorganization.


60. See Cecile Gutscher, Commercial Banks Flock to Ireland Seeking Tax Breaks, Wall St. J. Eur., Jan. 15, 1997, at 19, 1997 WL-WSJE 2804694 (describing the characteristics of Ireland that are favorable to securitization, including the absence of tax on dividends, interest income, and capital gains, low corporate tax rate, and the avoidance of onerous withholding taxes as a result of the double tax treaty network Ireland enjoys with the United States and its European neighbors).

61. See Frankel, supra note 3, at 256. Predictable laws become particularly important when the transaction involves several independent parties, especially if the parties or the assets are located in different jurisdictions. Id. at 257.

62. Refer to Part I.B supra.

63. See Frankel, supra note 3, at 260, 275.

64. Financial assets originated in one country are often structured in another country. For example, in 1997, the Dutch Supreme Court held that parties have the
Obtaining beneficial regulatory and tax treatment by artfully choosing the most favorable jurisdiction is a possible solution; however, this can create, as well as solve, problems. It is difficult to draw the line between unethical tax and regulation avoidance and good-faith attempts to optimize a transaction by choosing a jurisdiction with more favorable legal and tax regimes, warranting special attention to the way the foreign jurisdiction regulates tax haven and offshore transactions.

The choice of law issue may become less and less important because of increasing transaction uniformity, at least when it comes to forms and documentation. When domestic banks wish to sell their financial products (loans) abroad, the buyers will, in large part, dictate the underwriting standards and specifications, making local practices and standards irrelevant. Also, the International Monetary Fund (IMF) and the World Bank condition their aid on adopting U.S.-style commercial law, often including form indentures and model laws.


   a. Securities Laws and Investor Protection. When the originator transfers receivables to the SPV, or when the SPV issues securities, they become subject to securities and investment laws. In the United States, four major statutes establish disclosure requirements for companies issuing debt or equity: the Securities Act of 1933, the Securities Exchange Act, the Freedom to Determine Choice of Law in the Assignment of Receivables, Increasing the Attractiveness of the Netherlands as a Securitization Jurisdiction. See Piet-Hein de Jager, The Netherlands Gives Securitization a Double Boost, 16 INT'L FIN. L. REV., Sept. 1997, at 47, 47–48. Indonesian originators, for example, often choose the Netherlands to create the SPV, making the subsequent transactions carried offshore nontaxable events in Indonesia. Ahmed, supra note 6, at 854.

65. The “not so positive” example of regulation avoidance is money laundering; another example is the use of barter to avoid foreign currency restrictions. See Robert D. Kase, Petroleum Perestroika, 26 COLUM. J. WORLD BUS., Winter 1992, at 16, 26 (describing a transaction in which U.S. wheat was traded for Russian vodka, which then was traded to Germany for Deutsche marks and later exchanged for U.S. dollars).

66. See Frankel, supra note 3, at 267 (describing a small number of companies that establish standards for mortgage lending in the United States and noting that the Government National Mortgage Association (Ginnie Mae), the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac), the largest mortgage buyers, “virtually establish the underwriting standards for mortgage lending, . . . affect[ing] the prudence standards of U.S. banks that are mortgage lenders).


68. There is a multitude of legislative acts, regulations, opinion letters, and other sources of primary authority constituting the body of securities law in the United States;
of 1934,\textsuperscript{70} the Trust Indenture Act of 1939,\textsuperscript{71} and the 1940 Investment Company Act.\textsuperscript{72} The SPV issues securities serviced by the cash flow from the underlying collateral\textsuperscript{73} and, because the SPV is bankruptcy remote from the originator, the most valuable information to the investors and rating agencies is information about the underlying collateral.\textsuperscript{74}

Such information may be unavailable in non-U.S. jurisdictions for several practical reasons, among them the lack of investor protection mechanisms such as disclosure requirements. Without information about the collateral, the securitization may fail because investors will be unable to evaluate the entity and asset risks associated with these securities, and the originator will not be able to raise necessary funds by issuing securities through an SPV.

In addition to the disclosure requirements, U.S. securities law provides for “control person” liability when false or misleading materials are offered.\textsuperscript{75} Absent “control person” liability, a wronged investor’s only source for recovery . . . would be against an issuer”—an SPV that most likely has no resources to pay.\textsuperscript{76} Such expanded liability creates an additional investor protection mechanism by encouraging full disclosure and promoting efficient markets, without substantial impediments to the securitization transaction itself.\textsuperscript{77}

\begin{footnotesize}
\begin{enumerate}
\item See id. § 77aaa.
\item See id. § 80a-1. An SPV issuing securities or accepting receivables from the originator may become an “investment company” within the meaning of the Act, which requires “any entity principally engaged in owning or holding ‘securities,’ . . . subject to certain exemptions, [to] register with the [SEC] as an investment company.” See Schwarcz, The New Way to Securitize Assets, supra note 41, at 628.
\item Refer to Part I.A supra (describing a securitization transaction).
\item Refer to Part I.B supra (explaining that an SPV’s bankruptcy remoteness from the originator gives the originator the ability to raise capital at a lower cost).
\item See 15 U.S.C. § 77k (1994) (listing persons liable for false or misleading information contained in a registration statement).
\item Feldkamp, supra note 58, at 9.
\item Id. (“[B]roader application of regulatory liability fosters the creation of efficient markets by assuring broader disclosure responsibility.”).
\end{enumerate}
\end{footnotesize}
Inadequate investor protection mechanisms may discourage potential investors from getting involved in securitization. Although this may not be a problem with large institutional investors who may exercise their leverage to acquire necessary information, it might present a problem for transactions issuing securities to the public. Thus, in transnational securitizations involving public offerings it is wise to investigate disclosure laws and other protective mechanisms in the target jurisdiction; indeed, some countries have already begun adopting such protective mechanisms.\textsuperscript{78}

b. Freedom of Exchange. The ability to trade a receivable without the obligor’s permission is an essential legal prerequisite to effective securitization.\textsuperscript{79} Prior to the adoption of the Uniform Commercial Code (UCC), “many U.S. banks . . . required borrower consent to sell loans.”\textsuperscript{80} The adoption of Article 9 declared sale restrictions by debtors to be “ineffective.”\textsuperscript{81} Some jurisdictions, however, still require debtor consent to sell his loan to another financial institution.\textsuperscript{82} The impracticability of obtaining consent from every debtor when pooling hundreds of loans for sale to an SPV creates a major impediment to securitization that could prevent securitization of CMOs and other debt by financial institutions.\textsuperscript{83}

\textsuperscript{78} For example, in May 2000, an amendment to the Investment Trust Law was promulgated in Japan that, among other things, contained some investor protection mechanisms, such as an “obligation upon such investment managers to enforce the standard of care of a prudent manager and a restriction imposed on the same not to engage in transactions in conflict with the interests of the investors.” Ono & Ueno, \textit{supra} note 17, at 21, 26.

\textsuperscript{79} Feldkamp, \textit{supra} note 58, at 7.

\textsuperscript{80} Id. (“Prior to the general adoption of the . . . [UCC], it was very difficult for . . . banks to liquefy portfolios . . . [because] courts continued to follow cases adopted 200 years earlier . . . allow[ing] debtors to restrict the sale or repledge of their obligations.”).

\textsuperscript{81} See U.C.C. § 9-318(4) (2000).

\textsuperscript{82} Before October 1, 1999, “a mere notice to the debtor was not sufficient to constitute a valid transfer under [Chinese] law” without the debtor’s consent. See Jonathan Zhifeng Zhou, \textit{China: Launch of the Securitization Market in the PRC? Still a Long Way to Go}, in \textit{SEcuritization YEARBOOK 2000}, supra note 17, at 18. Article 80 of the P.R.C. Contract Law allows “a contracting party to transfer its rights under the contract by serving a notice to its counter-party,” but consent is still required if obligations are transferred simultaneously with the right. Id.

\textsuperscript{83} For example, assignment of the collection rights under a mortgage loan in Mexico must satisfy the same formal requirements as the original loan (formalized before a Notary Public and recorded with the Public Registry), making the sale of mortgage loans to the SPV in Mexico very costly. Carlos Aiza Haddad, \textit{The Securitization of Assets in Mexico}, 7 U.S.-MEXICO L.J. 141, 147 (1999). However, “all but four of the State Civil Codes of Mexico have been amended . . . not [to] require [such] formalities.” Id.
c. Business Law. Setting up the SPV can create additional costs. In civil law countries that do not allow for “pass-through” structures such as trusts or silent partnership relationships, securitization may “be achieved by placing assets in an offshore ‘haven,’” adding to transaction costs. Set-up costs, franchise fees, absence of limited liability, various restrictions on foreign entities’ activities in the capital and securities markets, minimum capitalization requirements and other corporate law issues can contribute to the financing cost, making other financing sources more attractive. More important, local laws may not allow for the creation of a satisfactory bankruptcy-remote entity, jeopardizing the entire transaction.

d. Secured Financing Laws. The UCC plays another important role in the U.S. legal framework; protecting the transfer of receivables against third party claims and bankruptcy. To issue investment-grade securities, the SPV must be “bankruptcy-remote”—it must be unaffected by the originator’s possible bankruptcy. When the originator transfers assets to the SPV, potential investors buying into the pool of assets must be able to establish that these assets now belong to the SPV “free and clear” of any third party claims. The UCC

84. For example, the Japanese corporate law makes it expensive to set up an SPV, requiring minimum capital contributions “of 10 million yen, at least three directors and an auditor.” Hideki Kanda, Securitization in Japan, 8 DUKE J. COMP. & INT’L L. 359, 360 (1998) (citing SHOHO (Commercial Code), arts. 168-4, 255, 273). Pakistan imposes on SPVs a minimum capital requirement of Rupees 1 million ($18,600). Rashed Idrees, Securitization in Pakistan: There Is a Future, in SECURITIZATION YEARBOOK 2000, supra note 17, at 34, 35.

85. Feldkamp, supra note 58, at 9.

86. See U.C.C. §§ 9-302–9-305 (2000), (providing perfection procedures, usually accomplished by the filing of UCC-1 financing statements). The Japanese Civil Code provides for perfection of the receivables assignment for securitization. See Yoshiki Shimada & Shinji Itoh, Japanese Asset Securitization: A Guide for Practitioners, 38 HARV. INT’L L.J. 171, 179 n.22 (1997) (translating MINPO [Japanese Civil Code], Law No. 89 of 1896, art. 467, which specifies procedures for perfecting the assignment of receivables for securitization). In 1993, Japan’s National Diet also enacted a special law to implement legislation encouraging asset securitization, the Law Relating to the Regulation of Business Concerning Specified Claims, Etc., Law No. 77 of 1993 [MITI Law], named after its original proponent, the Ministry of International Trade and Industry (MITI), which “has regulatory and supervisory jurisdiction over non-bank finance[ing] companies such as leasing and credit card companies.” Id., at 174 & n.9. However, the “law of legal perfection’ has been a major roadblock to Japanese securitization,” requiring approval from each individual borrower to sell loans into a master trust, necessary for the deal to be bankruptcy-remote. See Reinebach, Japan’s Capital-Hungry Banks, supra note 45, at 17 (commenting that the legislation will likely be overturned).

87. Refer to Part I.B supra (describing a securitization transaction).

88. Where pre-existing creditors receive security for their antecedent debt, the granting of security reduces the assets on which the remaining unsecured creditors can levy and, thereby, increases the risk for such unsecured creditors. Mexico, for example,
establishes a disclosure system that allows investors to confirm the ownership of, and any security interests in, the collateral, eliminating some asset risks associated with potential ownership and security interest priority disputes. 89

Several countries have legal frameworks similar to that of the United States, 90 but the frameworks differ from country to country, with more elaborate legislation and, perhaps, higher compliance costs in the countries with developed financial infrastructures. It goes without saying that utilizing local counsel is essential when issuing securities in the local market or using local collateral. Absence of a filing and disclosure system for resolving potential ownership disputes as to collateral—such as that required by the SEC—may discourage investors from buying SPV-issued securities and impede the originator’s ability to raise necessary financing.

e. Banking Laws. Restrictive banking laws may also present a regulatory obstacle for commercial banks interested in securitization. 91 Furthermore, the banking industry can be very

lacks a system that would permit prompt recording of liens and mortgages with the Registry of Public Property; commentators note this is still to be addressed. See Haddad, supra note 83, at 143. Bankruptcy preference laws address such potential inequality. See 11 U.S.C. § 547 (1994) (providing preference laws that give secured creditors priority over unsecured creditors). The legislative history for § 547 indicates an intention to “modernize[] . . . preference provisions and bring[ ] them more into conformity with commercial practice and the Uniform Commercial Code.” See Hon. Jo Ann C. Stevenson & Norman C. Witte, Bankruptcy, 1993 DETROIT C.L. REV. 319, 339 (citing S. REP. NO. 98-989, § 87 (1978)). In China, “secured creditors enjoy priority as to payment with respect to the collateral security.” Jerome A. Cohen & John E. Lange, The Chinese Legal System: A Primer for Investors, 17 N.Y.L. SCH. J. INT’L & COMP. L. 345, 372 (1997). “The priority of payments to other claimants in the event of a liquidation is: (i) expenses of the liquidation committee, (ii) accrued and unpaid salaries and labor insurance, (iii) accrued and unpaid taxes and (iv) all other unsecured claims and insufficiently secured claims (to the extent of the unsecured amount).” Id.

89. See UCC §§ 9-301, 9-305 (governing perfection and priority of security interests, including security interests in investment property). One complication relating to doing business in a civil law country is that, while civil law recognizes security interests and priority rights, it “remain[s] silent regarding the application of a security interest holder’s priority rights in a dispute involving multiple security interest holders.” Kevin T.S. Kong, Prospects for Asset Securitization Within China’s Legal Framework: The Two-Tiered Model, 32 CORNELL INT’L L.J. 237, 252–53 (1998).


91. See, e.g., Haddad, supra note 83, at 142 (discussing how Article 93 of Mexico’s banking laws makes it difficult for Mexican commercial banks to participate in securitization transactions). For example, “Mexican [commercial] banks are disallowed from transferring their assets to any third party except for other Mexican banks, the
protective of its status as the primary capital source and lobby against securitization. Whether resistance comes from the government or the banking community, it may stop securitization attempts in their tracks.

f. Property Laws. In securitizations involving private property, especially real property, such as leases and mortgages, private property rights may also become an issue. This problem relates to disclosure issues in secured lending. Investors need information about the quality of the collateral and may not be willing to invest in issues supported by pooled mortgage loans if they cannot verify title or third party claims on the real property in question, or if the title is conditional.

g. Trust Laws. SPVs are usually structured as private trusts. Asset securitization trusts are the issuers of a large fraction of all outstanding American debt securities (worth more than $2 trillion). Civil law countries, such as most European countries and China, do not have a trust concept, which is a common law institution based on a duality of ownership (legal and equitable), making it difficult to establish an adequate SPV.

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Mexican Central Bank (Banco de México), or trusts created by the Mexican Government for economic development. See John K. Thompson, Organization for Economic Cooperation and Development Securitization: An International Perspective 88–89 (1995) (describing the Japanese banking industry as protective of its status).


93. For example, in China, the usual property right in land is not fee simple, but some type of long-term land use right. Cohen & Lange, supra note 88, at 361–62 [U]ntil a grant fee is paid and a land grant contract is entered into with the relevant land bureau, land is held in the PRC only pursuant to ‘allocated’ land use rights, which may be revoked with minimal compensation.” Id.


96. Hansmann & Mattei, supra note 94, at 435; Zhou, supra note 82, at 19 (stating that the P.R.C. lacks the trust concept).

97. See Elaine de Paula Palmer, Brazil: Securitization: The Main Legal Aspects, in Securitization Yearbook 2000, supra note 17, at 72, 74 (commenting on the limited concept of trusts in Brazil that achieves the basic purpose of establishing a trust “through . . . the true sale of the receivables to [the SPV,] and . . . the granting of fiduciary duties to the trustee of the bonds to be issued by the SPV, which, unlike a trust, does not eliminate the risk of possible consolidation of the originator’s assets with those of the SPV in case of bankruptcy).
h. Credit Enhancement Mechanisms. SPVs are able to receive a higher credit rating than the originator through various credit enhancement mechanisms, allowing it to receive financing at a lower cost. Credit enhancement, among other things, allows the SPV to address the default risk through the use of guarantees, letters of credit, irrevocable credit lines, third-party insurance, or over-collateralization. Legal frameworks enabling at least some credit enhancement forms are essential to any securitization structure.

3. Bankruptcy Law. Bankruptcy laws are a crucial element of the securitization framework. In a securitization, the originator’s receivables are sold to a bankruptcy-remote SPV in a “true sale.” A true sale is a sale that severs the legal and beneficial interests of an asset and is sufficient under bankruptcy law to remove the receivables from the originator’s bankruptcy estate. This protects the investors’ ability to receive payment on their asset-backed securities despite the originator’s bankruptcy. This also reduces “monitoring costs” because a bankruptcy remote structure separates the SPV’s securities payment source from risks associated with the originator, largely eliminating the need to monitor the originator’s financial condition, except for the monitoring associated with servicing and collecting the receivables by the originator.

98. Refer to Part I.B supra (describing a securitization transaction).
99. Schwarz, The New Way to Securitize Assets, supra note 41, at 611 (“The goal is [to have] a creditworthy third party assure[] payment of all or a portion of the securities issued by the SPV.”).
100. Refer to Part I.B supra (discussing credit enhancement as a securitization stage).
101. SCHWARZ, STRUCTURED FINANCE, supra note 13, at 28–35 (outlining the following factors that are relevant in determining whether a transfer of receivables is a sale or a secured loan: recourse, retained rights and right to surplus, the pricing mechanism, and the administration and collection of accounts).
102. See id. at 28–29 (indicating that the term “true sale” is misleading because a transfer of receivables might be a sale for some purposes and not for others).
103. See 11 U.S.C. § 541 (1994). Securitization is unlikely to create a fraudulent conveyance under § 548 of the Bankruptcy Code (or equivalent state fraudulent transfer law), because the purchase price paid to the originator is normally a reasonable exchange for the receivables sold. See SCHWARZ, STRUCTURED FINANCE, supra note 13, at 36 (noting that in a typical structured finance transaction, the purchase price usually will be determined on an arm’s-length basis).
104. Schwarz, Alchemy of Securitization, supra note 12, at 151. “The SPV’s receivables, for example, cannot be claimed by unsecured creditors of the originator except through the originator’s equity interest in the SPV.” Id. at 151 n.60.
105. Id. at 151.
Protecting the SPV from the originator’s possible bankruptcy can be a tedious task. The U.S. Bankruptcy Code offers important benefits and protections necessary for isolating assets transferred to the SPV from the originator and avoiding the risk of “substantive consolidation.” Other countries are in the process of creating similar protections.

4. Tax System. Tax law in the area of securitization is not always clear, and a large part of tax law governing securitization was developed in connection with transactions that have “little to

106. See Schwarcz, The New Way to Securitize Assets, supra note 41, at 613–18, for a discussion on issues related to the creation of a bankruptcy-remote SPV, and, in particular, the originator’s ability to cause the SPV to file a voluntary bankruptcy petition under section 303 of the Federal Bankruptcy Code and limiting the circumstances under which creditors can force the SPV into involuntary bankruptcy under section 303(b).

107. Under section 362(a) of the Bankruptcy Code, the filing of a bankruptcy petition automatically “stays” all creditors from exercising their rights to the pledged collateral. 11 U.S.C. § 362(a) (1999). A bankruptcy court may permit a debtor to use pledged collateral to aid in the debtor’s reorganization, or to incur debt with a lien on assets that is prior to the lien of existing creditors. See id. §§ 362(d)(2)(B), 363(d), 364(d)(1). Another important element of the U.S. bankruptcy framework is the fiduciary duty of a corporation “in the vicinity of insolvency” to its creditors. The Delaware Supreme Court recently put debtors on notice that near-bankrupt corporations must be mindful of their responsibilities to act in their creditors’ interests and not to their detriment. Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp., No. CIV.A.12150, 1991 WL 277613, at *11554 & n.55 (Del. Ch. Dec. 30, 1991). “[T]he court noted that a board of directors of a corporation in the ‘vicinity of insolvency’ owes a fiduciary duty not only to its shareholders but also to its creditors.” Schwarcz, Alchemy of Securitization, supra note 12, at 147–48. “This ruling gives greater assurance that a troubled corporation will not speculate with the cash received from a securitization to the detriment of creditors.” Id. at 148.

108. This equitable doctrine may allow a court to consolidate the assets and liabilities of the originator and the SPV. See Schwarcz, The New Way to Securitize Assets, supra note 41, at 616 (discussing the elements and factors to consider when determining whether or not substantive consolidation should occur).

109. Thailand introduced implementing legislation to create insolvency and trustee laws paralleling the U.S. legal structure. See STANDARD & POOR’S, STRUCTURED FINANCE ASIA 3 (1997). China passed the Law of the People’s Republic of China on Enterprise Bankruptcy (for Trial Implementation). Cohen & Lange, supra note 88, at 371–72 (noting that the Trial Bankruptcy Law, promulgated in 1986, “applies only to state-owned enterprises,” and, despite some creditor protection, is “merely the first step in a legislative process that may ultimately lead to a workable bankruptcy law regime,” considering its limited scope, the judicial and administrative discretion involved in commencing a bankruptcy proceeding, and the lack of experience in administering procedures under the law). China also has the Company Law and the Code of Civil Procedure, which also include bankruptcy provisions. Id. at 371. As a “response to the Asian financial crisis and pursuant to the Memorandum of Economic and Financial Policy executed with the [IMF],” the Indonesian government enacted the “New Bankruptcy Law.” Ahmed, supra note 6, at 856. The law was enacted as an Amendment to the Bankruptcy Law, amending some provisions of the old law “with the aim [of] making the law more user-friendly.” Id. Under this law, “a bankruptcy petition in connection with a bank may only be submitted by Bank Indonesia, the central bank of Indonesia,” enhancing the bankruptcy remoteness because the central bank “will likely want to maintain the legitimacy of banks as custodians.” Id. at 856–57.
do with asset securitization.” The tax system can predetermine the transaction’s form and structure in order to minimize the tax burden and avoid unexpected tax costs.

Taxation is governed by the tax laws of the SPV’s incorporating jurisdiction. The SPV can also be affected by tax laws in jurisdictions where it is deemed to be engaged in business. If the SPV is formed in the United States to issue securities in U.S. markets (even if collateral is located elsewhere), normal U.S. tax rules govern. Investor taxation depends on the tax laws of each investor’s jurisdiction, and tax characterization of securities issued for investors in the SPV’s jurisdiction may also be relevant to tax planning.

a. Sale or Loan? The important decision in cross-border securitization regarding the form of the transaction from the tax perspective is whether to structure the transfer of assets from the originator to the SPV as a sale or a loan. The company can structure the transaction to obtain the most beneficial tax treatment available under the jurisdiction’s laws.


112. Id.

113. Thus, if the SPV were formed as a partnership or grantor trust (for tax purposes), there would be no entity level tax; if it were formed as a corporation, however, there could be an entity level tax. See Boris I. Bittker & James S. Eustice, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 1.07[2] (6th ed. 1998) (discussing the corporate form versus the partnership); SECURITIZATION: ASSET-BACKED AND MORTGAGE-BACKED SECURITIES § 4.03.B.1 (Ronald S. Borod ed., 1991) (discussing choice of entity issues and noting that “[t]he use of a corporate issuer . . . entail[s] the imposition of a corporate level tax,” whereas a partnership avoids “an additional level of tax on the issuer and, therefore, on the issuer’s equity holders”). Such entity-level taxation may reduce cash flow available to pay the SPV’s investors.

114. The issue of whether a transfer is a sale or a loan will depend on whether benefits and burdens of asset ownership have been transferred. Schwarcz, The Universal Language, supra note 111, at 248 & n.61 (noting that it will also depend on the legal context of the inquiry—bankruptcy, tax, or accounting).

115. In the United States, if the transaction is structured as borrowing for tax purposes, the interest payments made to pool securities holders are deductible. See I.R.C. § 163 (1994 & Supp. V 1999) (stating the general rule that all interest paid or accrued on indebtedness is deductible). If the transaction is structured as a sale of assets, the interest payments are not deductible, and the company may have to include any resulting gain or loss on the sale in its income. See id. § 61(a)(3) (gains derived from dealings in property are income); I.R.C. § 1001 (recognition of amounts realized from sale or other disposition of property). Thus, in the United States, structuring securitization as borrowing often is viewed as more desirable because such treatment avoids entity-level taxation, permits the seller to deduct interest payments made on pool securities structured as debt, and prevents the recognition of gain or loss on the conveyance of receivables to the pool. Tax statutes and regulations specify the conditions that must be met in order to qualify for the
the legal context can determine the appropriate treatment, because a transaction can be treated as a “loan” for tax purposes and as a “sale” for accounting. The decision to structure a transaction as a sale or a loan requires a thorough investigation of available tax treatments, corporate structures and accounting rules to ensure that asset risks are truly separated from the entity risks associated with the originator.

b. Tax Benefits. Foreign jurisdictions may not be able to offer the tax benefits that securitization transactions enjoy in the United States. This may increase transaction costs and make alternative financing methods more attractive. Such tax benefits include a reduction in agency costs by decreasing regulatory costs affecting some companies, beneficial tax treatment of Financial Asset Securitization Investment Trusts (FASITs), and investment safe harbors.

At the same time, the tax treatment of various securitization-related transactions abroad may be less stringent than in the United States. “Conduit” regulations, limitations on statutory exemptions and other anti-avoidance restrictions under U.S. law can outweigh the possible tax advantages. Still, in some situations it is possible to at least achieve tax neutrality.

borrowing status for tax purposes. See SEcuritize: ASSET-Backed and MORTGAGE-Backed SEcURITIES, supra note 113, §§ 4.02.A, 4.02.C.1, 4.03.B.1, 4.03.C.2 (discussing qualifications that an owner trust must meet to be classified as a fixed investment trust or a partnership).

116. See Hill, Sweetener for Lemons, supra note 12, at 1103 (noting, however, that securitization will not result in a tax treatment that a firm would not otherwise be able to obtain).

117. Such benefits include the reduction of regulatory costs in regulatory regimes, for example, regimes governing insurers and health care providers, or regulatory schemes mandating “adequate” capital levels, which securitization allows to achieve cost-effectively. See id. at 1100–01 & n.169.

118. The sale versus loan and entity-level tax issues do not arise under U.S. law if the transaction uses a FASIT. FASIT is a new tax vehicle governed by I.R.C. §§ 860H–860L. Although FASIT rules, which came into effect September 1, 1997, do not apply to transactions in foreign jurisdictions, FASITs could be used in the United States to hold non-U.S. obligations or to issue interests to foreign investors, subject to certain limitations. Willys H. Schneider, Selected United States Tax Issues in Cross-Border Securitizations, 8 DUKE J. COMP. & INT'L L. 453, 453 & n.1 (1998) (suggesting that widespread use of FASIT transactions “likely will await issuance of regulations”).

119. The U.S. withholding tax on interest under I.R.C. §§ 1441–1442 (a thirty percent tax rate) is subject to a statutory exemption for “portfolio interest” that applies to interest paid on registered obligations and to bearer obligations that are targeted to non-U.S. investors. See I.R.C. §§ 871(h), 881(c)(3)(A), 1441, 1442. It applies only to certain transactions, making U.S. and non-U.S. withholding tax a factor to consider. Schneider, supra note 118, at 454.

120. When an SPV is established in a tax haven jurisdiction, and payments to the SPV originate in the United States, “conduit” regulations provide that if tax avoidance constitutes a principal purpose of a transaction using an SPV in an intermediary
c. Tax Burdens. Some assets that may become a potential target for securitization, such as real estate, carry with them inherent tax burdens that differ from jurisdiction to jurisdiction.122 Investors may also be subject to withholding taxes on cross-border rental, interest, and, in some jurisdictions, even principal payments.123 These additional tax costs need to be taken into consideration during the planning stages.

d. Equal Treatment. Tax laws also need to offer asset-backed security investors treatment that does not place them at a competitive disadvantage with other investors.124 This constitutes an additional reason to investigate whether the laws of the target jurisdiction allow for the creation of pass-through entities allocating tax attributes of underlying assets directly to investors and not taxing the entity that owns the assets only nominally.125

e. Multi-currency Issues. Another tax issue in cross-border securitization arises in conjunction with cross-currency jurisdiction, the “financing arrangement,” as defined in Temp. Treas. Reg. § 1.881-3(a)(2)(i), can be recharacterized by ignoring the SPV’s participation, which results in an increased U.S. withholding tax. Id. § 1.881-3(a), (b) (allowing district directors to disregard the participation of one or more intermediate entities in a financing arrangement where such entities are acting as conduit entities).

121. See Zhou, supra note 82, at 19 (stating that value added tax does not apply to the transfer of receivables in China, making it possible to achieve a tax neutral position).

122. See Ono & Ueno, supra note 17, at 24 (describing relatively high tax rates and multiple taxes associated with real property transfer, acquisition and holding, such as registration tax, real property acquisition tax, consumption tax, capital gain tax, land value tax, fixed asset tax and city planning tax, as creating demand for amendments to the relevant tax laws).

123. Withholding taxes may arise in the following situations: (i) if there is a tax sale of receivables with obligors in one country paying interest on the underlying obligations to an SPV or investors in another country; (ii) if a transaction between the originator in one country and an SPV or ultimate investor in another country is treated as a tax loan to the originator; or (iii) if an SPV in one country raises money by issuing debt to holders in another country.

124. Feldkamp, supra note 58, at 9 (discussing equal legal and tax rights for both the purchasers and the originators of asset-backed securities).

125. Id.
transactions. Swaps and other derivatives used to hedge currency exchange risks may cause recognition of gain or loss as a result of fluctuations in the relative value of U.S. dollars and the currency of the assets.\textsuperscript{126} Tax treaties containing “limitation of benefits” provisions\textsuperscript{127} and restrictions on transfers among related entities (such as multiple SPVs in different jurisdictions) may present additional considerations, compelling the need “to coordinate with each jurisdiction’s tax counsel, and . . . to obtain appropriate tax indemnities and gross-up provisions.”\textsuperscript{128}

Perhaps not all aspects of the existing U.S. tax system are vital to the existence of securitization. However, the existence of a comprehensive, developed, and predictable tax system itself is undoubtedly a prerequisite. Cost-benefit analysis for tax planning purposes is impossible in an underdeveloped or unstable environment. Although tax law is not known for stagnation, and it is unrealistic to expect no change at all, it is necessary to have at least a consistent tax policy to enable decisions regarding transaction form and structure at every stage.

5. Governmental Regulations and Restrictions. Government plays an increasingly important role in securitization transactions, even in such decentralized federalist nations as the United States.\textsuperscript{129} Licensing, exchange controls, debt moratoria, banking regulations, and sovereign immunity questions are some of the most important issues that must be taken into account when considering a transaction in a foreign jurisdiction.

In addition to being responsible for the onset of securitization transactions in the United States,\textsuperscript{130} governmental agencies supported the expansion of the securitization technique

\textsuperscript{126} See Stephen M. Edge & Michael Murphy, \textit{UK Tax Considerations, in ASSET SECURITIZATION: INTERNATIONAL FINANCIAL AND LEGAL PERSPECTIVES} 147, 154–55 (Joseph Jude Norton & Paul R. Spellman eds., 1991) (commenting that asymmetrical treatment of currency depreciation versus gain or loss on the swap “may work for or against the issuer depending on the way the two currencies move in relation to each other during the life of the bonds”).

\textsuperscript{127} “[L]imitation of benefits’ provisions contained in many tax treaties . . . may restrict the availability of reduced treaty rates to recipients who do not maintain significant contacts with the treaty jurisdiction in question.” Schneider, \textit{supra} note 118, at 458. For an excellent discussion of tax treaties and tax issues in securitization, see \textit{id.} at 453–68.

\textsuperscript{128} Schwarcz, \textit{The Universal Language}, \textit{supra} note 111, at 251.

\textsuperscript{129} In the United States, most legislation in the area of securities, bankruptcy, currency controls, and other important areas affecting securitization is enacted on the federal level. U.S. \textit{CONST.} art. I, § 8.

\textsuperscript{130} Refer to Part I \textit{supra} (describing the history of securitization).
to include other assets. Without a doubt, government agencies will play a major role in “domesticating” securitization abroad; thus, the needs, objectives, policies, existing and proposed legislation, as well as cultural realities and business traditions in these countries remain an important consideration.

The need for capital may serve as an additional incentive for countries to adopt securitization-friendly legislation. In particular, Asian countries have a greater need to generate new capital, especially in light of the 1997 crisis. As a result, the governments of these countries have a greater incentive to pass securitization legislation.

Nevertheless, even in these countries, laws facilitating securitization often contain restrictions and limitations on the types of assets that can be securitized or on the types of originators. The regulatory oversight over the entire securitization transaction or its parts—including filing and

132. Several countries have already enacted such legislation. See Kong, supra note 89, at 244 & n.38 (citing STANDARD & POOR’S, STRUCTURED FINANCE ASIA 3 (1997), which names Indonesia and Thailand as examples of countries that have enacted securitization implementing legislation “specifically to facilitate asset securitization”).
133. Some jurisdictions may not recognize the security interest over future receivables (such as oil and gas receivables), whereas others may not even allow pledging contractual rights for the existing receivables, making some securitization structures that are used in other countries unusable in the target jurisdiction. E.g., Zhou, supra note 82, at 19 (stating that the “PRC laws tend not to recognize the security over the future receivables,” and it is still unclear whether contractual rights may be pledged).
134. In Japan, “non-bank finance companies have been prohibited from raising capital” by issuing debt, “and from using proceeds therefrom for their business operations.” See Shimada & Itoh, supra note 86, at 174 n.9 (referring to the Law Concerning Control of Acceptance of Contributions, Money Deposit and Interest, etc., Law No. 195 of 1954, and its various administrative interpretations and guidances). Consequently, such nonbanking entities became dependent on bank borrowing. MITI has tried to encourage them to lessen this dependence by diversifying their funding sources through securitization. See Hiji Inose, Non-banks to Bank on Asset-Backed Securities, NIKKEI Wkly., Jan. 25, 1992, LEXIS, News Library, Nikkei File. As the result of compromises between MITI and the Ministry of Finance (MOF) that seek to provide investors acquiring asset-backed securities with the same disclosure requirement benefits and protections as under the Securities and Exchange Law of 1948, the current MITI Law applies only to certain originators with certain receivables, such as credit card companies, leasing companies, and other nonbank finance entities. Shimada & Itoh, supra note 86, at 179 & n.21 (translating the MITI law). It also applies only to specific receivables, the so-called “Specified Claims” that include installment loans and lease and credit card receivables. Id. at 180 n.26. The MITI Law “also restricts the available methods of securitization to those expressly authorized by the MITI Law... limiting the range of securitization structures available to the[se]... non-bank finance companies.” Id. at 174 n.9 (citations omitted).
licensing requirements,135 and limited access to markets136—may substantially exceed that to which U.S. investors may be accustomed.137 Such restricted access may limit securitization opportunities, making debt securitizations impossible without meeting the restriction requirements. Compliance with a greater number of additional mandatory regulations138 usually means an increase in transaction cost and preparation time.139

Nevertheless, strong governmental involvement alone does not appear to be a major obstacle to successful securitization, considering the success of securitizations in civil law jurisdictions140 with significant regulatory oversight.141

135. Shimada & Itoh, supra note 86, at 183 & n.37 (discussing MITI Law, arts. 30, 52, and noting that both MITI and MOF must grant licenses to either the “Specified Claim Purchaser” or the “Individual Claims Dealer”).

136. Some jurisdictions, such as China, restrict access to their bond markets to the most profitable enterprises. Zhou, supra note 82, at 19 (citing P.R.C. Company Law and regulations stating that the Chinese bond market is available only to enterprises that in the past three consecutive years generated on average sufficient profits to “enable the issuer to repay one year’s interest on the bonds issued”).

137. Through the MITI Law, MITI reserves oversight over the entire asset securitization transaction. Shimada & Itoh, supra note 86, at 182–83 & n.36 (describing the filing requirements and review provisions contained in art. 4 allowing MITI to modify the transaction after a sixty day mandatory review period under article 4, paragraphs 1 and 2 of the Enforcement Regulations of the Law Relating to the Regulations and Business Concerning Specified Claims, etc.).

138. For example, creating a security in China requires mandatory registration in numerous settings, including real estate mortgages, properties originally subject to property registration, patent, trademark, and guarantees. Todd R. Benson, Taking Security in China: Approaching U.S. Practices?, 21 YALE J. INT’L L. 183, 199 (1996). In the United States, registration is not mandatory and is generally necessary only to perfect a security interest. Id. Failure to register in China can invalidate entire transactions, suddenly leaving the secured party unsecured. Id. at 199 & n.90.

139. See id. at 199 (noting that documentary submission requirements can be quite detailed). Compliance with the legal requirements for perfecting an asset transfer is very costly, “requir[ing] notarial certification of individual loans and receivables one by one.” Hideki Kanda, Securitization in Japan, 8 DUKE J. COMP. & INT’L L. 359, 359 (1998). The countries most interested in foreign investment realize that this presents an obstacle to investment, and are slowly introducing changes to make their laws more efficient. See, e.g., Regulatory Watch in South Korea, BUS. ASIA, Oct. 4, 1999, 1999 WL 10768814 (listing changes the South Korean government has adopted to boost foreign investment, including enacting the Act Regarding Asset-Backed Securitization); Bulmer & Kim, supra note 123, at 28 (noting that Korean domestic securitization has developed rapidly after the adoption of the ABS Act in 1998).

6. Regulatory Stability. Clear and comprehensive laws and regulations alone are not enough. They must also be uniformly enforced to enhance regulatory certainty. Thus, additional problems arise in jurisdictions with strong regulatory involvement caused by the broad discretion enjoyed by officials issuing licenses and permits, making administrative decisions vital to the transaction. Personal connections remain important in many cultures. It is difficult to overemphasize the importance of understanding social, business, and cultural realities and their effect on business relationships in a given environment.

In sum, while knowledge of local laws is important, that alone is not enough. Using local counsel or consultants may be crucial to identifying potential issues and preventing unwanted surprises.


142. In many circumstances, parties can provide for additional protection by contracting for provisions that are inadequately covered by existing laws.

143. For a rule-of-law analysis and discussion of corruption as the enemy of certainty, see Bruce A. Markell, A View from the Field: Some Observations on the Effect of International Commercial Law Reform Efforts on the Rule of Law, 6 IND. J. GLOBAL LEGAL STUD. 497, 505 (1999) (opining that enhancing private greed over public need often subverts the cause of certainty).

144. Bribery and corruption are not necessarily the only by-products of broad discretion. For example, legal pragmatism as a characteristic of the Chinese legal system distinguishes between “paper law” (law in published regulations) and the law in action. Benson, supra note 138, at 188 (noting that even though such a distinction is generally understood of the law in any place, “the dichotomy seems more exaggerated in China”); Yu Xingzhong, Comment, Legal Pragmatism in the People’s Republic of China, 3 J. CHINESE L. 29, 30 (1989) (arguing that the legal pragmatism in China’s present legal system is seen as “the resort to ad hoc legal measures, the separation of legal doctrine from practice, the overemphasis on instrumental facets of laws, and the placement of policy before law”).

145. In China, “[a] complex web of informal personal connections (guanxi) runs throughout and beyond the formal structure” that outlasted and survived many government institutions, including Communism. Benson, supra note 138, at 190 & n.35 (footnote omitted). On the up side, such informal connections can increase the likelihood that an agreement will be enforced. Id. at 210 & n.172 (discussing the role of “extraofficial” processes in bringing pressure to resolve disputes).

146. For example, in Japan, there is an important customary rule in the financial services area that the lack of an explicit legal rule endorsing a certain activity is interpreted as a prohibition of that activity. Hideki Kanda, Politics, Formalism, and the Elusive Goal of Investor Protection: Regulation of Structured Investment Funds in Japan, 12 U. PA. J. INT’L BUS. L. 569, 582 (1991).

147. Short of fines and imprisonment, the ignorance of local business culture can be no less harmful as ignorance of local laws.
7. Debt Collection and Enforcement Issues. Contracts are little more than paper if they are unenforceable. The ability to protect an SPV from insolvency claims against the originator is the foundation of securitization.

Even in countries with a developed legal system, asset purchasers may not have the same access as the originators to enforce contracts in courts of law. Some jurisdictions have laws restricting enforcement by loan purchasers or servicers that were "designed to 'protect' borrowers from the presumed inappropriate collection practices of 'bad' loan purchasers." It is necessary to be on the lookout for laws precluding inappropriate collection practices that, although useful, may also excessively restrict asset sales, therefore restricting high-grade securitization.

B. Economic and Market Factors

1. Accounting Standards. In the absence of meaningful accounting rules, even substantively successful securitizations can fail. Because securitization is based on a sale of financial assets that separates the assets from the originator's risks, it is important that the transfers of financial assets are accounted for as a sale. Financial asset accounting presents special problems because of a "fundamental disconnect . . . among law, economics and accounting when it comes to these unique assets."

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148. Roscoe Pound, Mechanical Jurisprudence, 8 Colum. L. Rev. 605, 619 (1908) ("The life of the law is in its enforcement.").

149. Refer to Part I.B supra (describing a securitization transaction and bankruptcy remoteness). See Cohen & Lange, supra note 88, for an excellent discussion on the creation of binding obligations under Chinese law, including capacity, authority, and approval prerequisites to enforceability. The General Principles of Civil Law (the Chinese Civil Code) contains several basic contract principles. It has a bifurcated system of contract law, where the Economic Contract Law of 1993 applies to contracts between Chinese entities, and the Foreign Economic Contract Law of 1985 (FECL) applies to most contracts between foreign and Chinese economic entities. Id. Most contract law principles under the FECL are similar to laws in Western jurisdictions; parties are also permitted to choose the law that will govern the resolution of contract disputes, except for joint venture and exploration and development of natural resources contracts, which must be governed by Chinese law. Id.

150. Feldkamp, supra note 58, at 9 (discussing the need for originators and asset purchasers to have equal access to the courts).

151. Id.

152. Refer to Part I.A supra (defining securitization as a sale of financial assets to a separate entity, making these assets independent from risks associated with the originator).

153. Feldkamp, supra note 58, at 8 (discussing alternative analyses for distinguishing sale and secured loan transactions, noting that there is no "economic" difference between the two and that, under the "financial component" doctrine, the
U.S. accounting rules consistently adopt “‘law’ as the primary basis of distinction between a secured loan and a sale,” thus allowing “sold” financial assets to be separated from originator’s risks. However, a foreign jurisdiction may lack special accounting and legal rules, allowing legal, not economic, substance to distinguish a “true sale” from a secured loan. In the absence of such rules, it may not be possible to sever the tie between the SPV and the originator, defeating the purpose of the transaction—to separate asset and entity risks.

Alternatively, a country may have special accounting rules for the off-balance treatment of assets which do not allow an originator to remove assets from its balance sheet unless special conditions are met. In that case, local counsel may need to issue an opinion as to “whether a transaction could still be determined to be a true sale . . . even when the originator would not be permitted to remove such real property from its balance sheet.”

On a more general level, less financially mature jurisdictions may not even use or recognize the Generally Accepted Accounting Principles (GAAP) or other accounting standards acceptable for the purpose of applying for a rating. Converting all financial and accounting records into a form acceptable to rating agencies may create additional, potentially significant, transaction costs.

2. Rating Agencies. There are four nationally recognized statistical rating organizations in the United States: Standard & Poor’s Ratings Group, Moody’s Investors Service, Inc., Fitch Investors Service, Inc., and Duff & Phelps, Inc. A financial instrument’s credit rating reflects the likelihood of full and timely interest and principal repayment by the issuer.

“accounting result . . . depend[s] on who, as a matter of some external standard, ‘owns’ each such component”).

154. See id. at 8–9 (stating that SFAS 77 relied on “legal form” and SFAS 125 relies on “legal isolation . . . even in bankruptcy or receivership”).

155. Refer to notes 47–51 supra and accompanying text (discussing asset and entity risks in securitization).

156. See Ono & Ueno, supra note 17, at 23 (describing new accounting rules in Japan that utilize the “risk/reward approach” by permitting an originator to remove real property from its balance sheet only if the risks and benefits associated with such property retained by it fall within about 5%, that is, when almost all the risks and benefits of such property are transferred to the SPV).

157. Id. at 24.

158. Refer to notes 168–70 infra and accompanying text (describing U.S. rating agencies giving ratings to non-U.S. structured finance transactions).

accordance with the instrument’s terms.\textsuperscript{160} Issued security ratings are different from issuer ratings where the issuer can be a corporation or a country.\textsuperscript{161}

Rating agencies reduce transaction and agency costs for investors.\textsuperscript{162} The agencies reduce the former by decreasing the cost of information and expert evaluation of the borrower’s credit risk,\textsuperscript{163} and reduce the latter due to the transparency of financial decisions and activities required as part of the rating process.

Rating agencies consider various factors, many of which may depend upon the underlying transaction, asset, and country involved.\textsuperscript{164} When rating securitizations in which assets are insulated from the originator’s credit risks, rating agencies are able to base their securities ratings on the creditworthiness of isolated assets alone.\textsuperscript{165} The rating methodologies are adjusted to reflect the law of the relevant jurisdiction,\textsuperscript{166} and thus may significantly alter the rating in civil law jurisdictions.\textsuperscript{167}

In the absence of adequate foreign ratings equivalents, U.S. rating agencies are often asked to rate non-U.S. structured

\textsuperscript{160} Solomon B. Samson & Gail I. Hessol, \textit{Ultimate Recovery in Ratings: A Conceptual Framework}, \textit{STANDARD & POOR’S CREDITWEEK}, Nov. 6, 1996, at 25, 25 (stating that “Standard & Poor’s issuer credit ratings . . . address the risk of full and timely payment on all obligations of [the particular] entity,” taking into consideration the ultimate recovery of all obligations).

\textsuperscript{161} Generally, the issuer rating is a “ceiling” for the issue rating, because a transaction’s creditworthiness cannot exceed the issuer’s creditworthiness, unless some method of credit enhancement is used. \textit{See} Dawson, \textit{supra} note 159 (citing the official view of the Standard & Poor’s Structured Finance Rating Group that “transactions using ‘contingent transfers’ . . . mechanisms should not be rated higher than the transferor’s issuer credit rating”); Schwarz, \textit{The New Way to Securitize Assets}, \textit{supra} note 41, at 611 (discussing such credit enhancement mechanisms as guarantees, letters of credit, irrevocable credit lines, and third-party insurance).

\textsuperscript{162} \textit{See} 1 FRANKEL, supra note 9, ¶ 9.16.

\textsuperscript{163} \textit{Id.}

\textsuperscript{164} \textit{See} Diane Audino, \textit{Securitizing Vacation Home Loans in Mexico}, \textit{STANDARD & POOR’S CREDITWEEK}, July 31, 1996, at 15, 16–17 (describing factors to be considered when financing Mexican vacation homes).

\textsuperscript{165} \textit{See} Dawson, \textit{supra} note 159, at 383 & n.12 (noting that the rating of securities is based primarily on the creditworthiness of isolated assets without regard to the seller’s or buyer’s creditworthiness).

\textsuperscript{166} For example, when commercial mortgage securitization debuted in France, \textit{STANDARD & POOR’S} had to adjust its U.S.-based analysis to account for French bankruptcy laws and other issues. Valerie Hart, \textit{Commercial Mortgage Securitization Debuts in France}, \textit{STANDARD & POOR’S CREDITWEEK}, Dec. 4, 1996, at 17, 17.

\textsuperscript{167} Dawson, \textit{supra} note 159, at 384–85. The absence of equitable principles and rigidity of civil law codes create special securitization problems, which sometimes are resolved due to special securitization enactments. It is necessary, however, to remember that equity-like or common law analysis may not be supported in the civil code jurisdictions. \textit{Id.} at 384 nn.16–17 (referring to various publications on securitization in non-U.S. jurisdictions such as Japan, France, Germany, Belgium, Argentina, Colombia, Brazil, Spain, Ireland, and others).
finance transactions. The rating agencies must then evaluate not only issue, asset, and sovereign risks, but also whether the formed SPV can truly function as such. In addition, rating agencies must evaluate whether the foreign jurisdiction has any legal theory similar to the U.S. theories of substantive consolidation, alter ego, and piercing the corporate veil.

Significant problems in the rating process may arise due to a lack of transparency. Credit agencies depend on the availability of information for their ratings. The lack of corporate transparency and absence of SEC-like registration and disclosure requirements can affect the accuracy of such ratings or make them unavailable, thereby increasing transaction and agency costs.

168. Refer to Part I.D supra (discussing securitization risks including asset, entity, sovereign, catastrophe, agricultural, project, and political risks).

169. The six-factor analysis is outlined in Standard & Poor's, Structured Finance Ratings Asset Backed Securities: Trade Receivable Criteria 44 (1996), including “separateness” or anti-commingling covenants, prohibition on engaging in any other activity, restrictions on incurring additional debt, restrictions on other business or activities, requirement of at least one independent director, and other factors. See Dawson, supra note 159, at 392–93.

170. For example, the legal systems in China and Eastern Europe lack transparency. Benson, supra note 138, at 192 (commenting that foreigners and even Chinese citizens cannot easily access many internal regulations); Securitization, Asset Fin. Int'l, Jan. 1, 1998, 1998 WL 26844018 (noting that the “lack of corporate transparency and difficulties in obtaining financial information are considerable obstacles to the launching of any securitizations”).
3. Multicurrency Issues. One of the obstacles to large-scale securitization in “pre-Euro” European capital markets was the fact that securities were denominated in various country-of-issue currencies, making it difficult for investors to trade bonds among countries.\textsuperscript{171} The advent of the Euro in January 2000 was predicted to provide a boost for both issuance and liquidity, especially for smaller European countries, because developed ABS markets already existed in the United Kingdom, France, and Germany.\textsuperscript{172} On the other hand, drastic decreases in currency values, partially due to the Asian crisis, increase the possibility of some form of exchange control.\textsuperscript{173}

4. Economic Stability. The United States has one of the most stable economies worldwide. It is characterized by developed financial and securities markets, low inflation, low and stable interest rate environment, and a strong economy that encourages spending.\textsuperscript{174}

Other factors have encouraged securitization growth in the United States, such as support given to the MBS market by the Federal government, competition among different classes of institutions (for example, banks, thrift institutions, securities houses, and institutional investors) for developing new products, and the general willingness of the legal, accounting, and tax systems, as well as the banking and securities supervisory authorities to accept securitization.\textsuperscript{175}

Securitizations are desirable in jurisdictions with developed

\textsuperscript{171} Reinebach, \textit{The Outlook for ABS, supra} note 56, at 26, 27 (noting that a lack of liquidity has been a major hindrance in Europe).

\textsuperscript{172} \textit{Id.} at 27 (stating that the Euro’s biggest impact will be on countries where the currencies are not “major”).

\textsuperscript{173} Ahmed, \textit{supra} note 6, at 823–24 (noting the possibility that one or more Asian countries may impose exchange controls); Zhou, \textit{supra} note 82, at 19. “The PRC government still exercises strict control over the conversion between Renminbi and foreign currencies under capital accounts[,]” if it will regard securitization as a financing in substance rather than sales of receivables, the sale of Renminbi receivables may require government approval as a capital accounts transaction. \textit{Id.}

\textsuperscript{174} A strong consumer-oriented economy encourages consumption and, thus, supports the proliferation of such financial products as credit cards, mortgage and consumer loans, rents, and royalties. These products are often used as collateral in asset securitization transactions, making a strong economy a major success factor in advancing the popularity of asset securitization. Reinebach, \textit{The Outlook for ABS, supra} note 56, at 26–27 (“At the macroeconomic level, a low and stable interest-rate environment has been a major impetus for issuers, while a strong economy has encouraged plenty of consumer spending, thus generating more securitizable receivables.”). Conversely, in weaker economies, consumer credit problems may pose major obstacles to securitization, threatening to reduce a bond’s value.

\textsuperscript{175} \textit{See JOHN K. THOMPSON, SECURITISATION: AN INTERNATIONAL PERSPECTIVE} 30–31 (1995) (crediting federal programs, that developed mortgage financing as well as many other factors, with developing mortgage financing).
financial infrastructures due to lower risks and lower transaction costs. Returns, however, on securitizations in “safe” jurisdictions are also lower. This is similar to the lower returns on securitizations of tried and tested products as opposed to using innovative techniques that may result in higher profits—but not always without a substantial risk of failure.176

Another paradox tied to the strong economy element is that many “safe” jurisdictions that are more attractive to investors due to decreased risks have a lower demand for securitizations.177 Countries with domestic banks in a strong financial position and well-developed mortgage finance systems are less eager to begin large-scale “American style” securitization.178 At the same time, unlike European countries, Asian countries have a greater need to generate new capital, giving their governments an incentive to pass new securitization laws.179

III. CONCLUSION

Securitization as a financing method is much more complicated than other methods, such as direct borrowing. The complexity and transaction costs associated with securitization may scare away potential clients who prefer loans as a simple and more familiar, although more expensive, funding source. Complicated, expensive procedures for setting up the SPV and registering and perfecting asset transfers may outweigh the benefits of securitization in some cases. Alternative financing methods such as direct loans can be simpler and better serve smaller clients.

Moreover, other issues associated with such economic factors as economic instability, liquidity problems—particularly in multiple-currency environments such as pre-Euro Europe—

176. Frankel, supra note 3, at 271 (speaking on the practice of giving away innovations in the area of finance). “[T]heir novelty produces uncertainty that may result in failure and losses. The greater the use of the innovation, the lower the users’ risks would be, and the more users will be willing to adopt it. . . . enhancing its value, thus proving the success of the innovation.” Id.

177. Some countries, including Sweden and Finland, view securitization as a possible means of addressing problems in their financial systems, such as bank decapitalization resulting from the banking crises in the late 1980s and early 1990s. But in Germany, Austria, Denmark, the Netherlands, and Switzerland, strong domestic banks and well-developed alternative structures for mortgage finance determined the not-so-strong demand for securitization on the part of the market participants. THOMPSON, supra note 175, at 35–36 (“Germany does not appear a most promising area of expansion for securitisation in the near future.”).

178. Id.

179. Refer to note 45 supra and accompanying text (describing securitization as one of the few ways for developing countries to obtain financing).
consumer credit problems (the worse the economy, the lower the consumption or the higher the default rate on consumer consumption loans such as credit cards), and the unavailability of asset portfolios large enough to diversify the collateral adequately to mitigate the risks, contribute to the cost of the transaction, necessitating a comparative cost analysis as to other methods of financing. The absence or inadequacy of the economic and market factors discussed above may not make a transaction impossible; however, it can make a transaction prohibitively expensive.

On the other hand, the absence of legal factors can make a transaction impossible. Many foreign legal and tax codes, insolvency and trust laws, as well as laws regulating asset transfers, were passed only recently and remain largely untested, especially in countries with developing financial and legislative infrastructures. Lack of corporate transparency (disclosure of the decision-making process within the corporate structure) and disclosure requirements similar to those under the 1933 Securities Act and the 1934 Securities Exchange Act can make ratings unavailable or possibly distort them due to making accurate information unavailable or verification impossible. Lack of such crucial information about the collateral, inability to create a bankruptcy-remote trust entity, as well as the inability to enforce legal rights through traditional channels will discourage investors from buying securities, crippling the SPV’s ability to raise funds.

Ironically, the role of securitization as an alternative source of funding means that countries with less developed financial infrastructures will have the most to gain from securitization. As long as the economic drive for funding and incentives for creating securitization-friendly infrastructures remain strong; the prospects for securitization remain rosy indeed.

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