Multi-Jurisdictional Framework of International Securitization: Understanding the Various Facets of this Transnational Process

Parikshit Dasgupta
Naoshir Vachha

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MULTI-JURISDICTIONAL FRAMEWORK OF INTERNATIONAL SECURITIZATION: UNDERSTANDING THE VARIOUS FACETS OF THIS TRANSNATIONAL PROCESS

PARIKSHIT DASGUPTA,* NAOSHIR VACHHA**

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* Mr. Dasgupta is an LL.M. candidate at the Harvard Law School pursuing research under the aegis of the Program of International Finance and Securities (Concentration). The author would like thank Professor Howell Jackson and Professor Allen Ferrell for providing valuable insight into the intricate world of financial regulation.

** Mr. Vachha is a corporate lawyer currently practicing with ALMT Legal, Mumbai, India. The author's areas of interest include capital markets, information technology law, law relating to arbitration and corporate commercial law. The author is presently conducting research on derivative trading in India and the global harmonization of contract law.
I. INTRODUCTION

This article introduces the reader to the process of securitization with particular emphasis on international securitization, which is also referred to as cross-border securitization. The article provides discussion on the various issues and considerations involved in international securitization.

The structuring of an international securitization revolves around two basic issues. The first issue requires determining the jurisdictions in which the cross-border securitization will operate. The second requires (1) ascertaining the applicable laws and (2) structuring the securitization so that it is consistent with those laws. Based on analysis of these issues, this article proposes that international securitization is regulated by a private law-making system; namely, the contract system. Additionally, this article asserts that the various processes of securitization are subject to the laws of the country in which the processes occur. Thus, a discussion of the creation and nature of international securitization law, as well as the various issues that arise in a cross-border securitization, is also provided.

Parts II and III of this article describe the process of securitization, as well as the rationale and the advantages stemming from this process. Part III introduces the process of international securitization and the issues involved in structuring an international securitization. Part IV explains the origin of
origin of international law with respect to securitization and investigates its nature. This section of the article demonstrates that international securitization law is a product of private contracts drafted and structured by lawyers, and, consequently, such law should bear the name *lex juris*. Part V describes a variety of issues and considerations involved in a cross-border securitization transaction that may cause difficulty in complying with applicable local law. Part V also makes brief reference to relevant provisions of the Convention on the Assignment of Receivables in International Trade. The article concludes that the process of securitization, as well as the legal concerns and regulations, are heading towards harmonization. As such, this harmonization should be encouraged to facilitate cross-border securitization.

II. THE CONCEPT OF SECURITIZATION

A. Introduction

Traditionally, companies raise money through the issuance of securities for equity participation in the company or through loans to the company. In such instances, the security holder has recourse to the company itself for the repayment of debt, which may be jeopardized by the bankruptcy of the company. In the case of securitization, however, the source of repayment is separated from the company, so the security holder is not dependent on the company for repayment and not threatened by the company's bankruptcy.

The term securitization may be defined as "[a] process of homogenizing and packaging financial instruments into a new fungible one." In securitization, a company partly deconstructs itself by separating certain types of highly liquid assets from the risks generally associated with the company.


This is achieved through the establishment of a separate entity known as a Special Purpose Vehicle ("SPV")\(^6\) to which these assets of the company are transferred. The SPV, in turn, issues securities to raise funds from the capital markets.\(^7\) Thus, the company uses these assets to raise funds in the capital markets\(^8\) at a lower cost than if the company had raised funds by directly issuing the debt itself. The company retains the savings generated by these lower costs while the buyers of the securities, issued by the SPV, benefit by holding investments with lower risk.\(^9\)

**B. The Process of Securitization**

In a typical securitization transaction, the company seeking to raise funds transfers assets to an SPV—organized especially for this purpose—to reduce the likelihood of bankruptcy.\(^10\) The transferring company is called the *originator* because it is the original company that supplies the assets.\(^11\) The assets themselves are typically payment obligations, which are owed to the originator from third parties. Generically, these obligations are referred to as receivables or financial assets.\(^12\) The entities obligated to pay the receivables are known as *obligors*.\(^13\)

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\(^6\) An SPV is merely another corporate entity distinct from the original company ("originator"), to which the receivables are transferred. Accordingly, the purpose of an SPV is to hold receivables and issue debt instruments. See generally SCHWARCZ, supra note 3.

\(^7\) See Claire A. Hill, *Securitization: A Low-Cost Sweetener for Lemons*, 74 WASH. U. L. Q. 1061, 1066-68 (1996) (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).

\(^8\) See JOHN DOWNES & JORDAN GOODMAN, DICTIONARY OF FINANCE AND INVESTMENT TERMS 82 (5th ed. 1998). Capital markets are defined as "markets where capital funds - debt and equity - are traded. Included are private placement sources of debt and equity as well as organized markets and exchanges." See id.

\(^9\) See Dvorak, supra note 3, at 548-49 (discussing how securitization leads to a bankruptcy remote SPV which can generate funds at a lower cost).


\(^12\) See SCHWARCZ, supra note 3. Receivables can be short term (typically due in thirty 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, and other agreements. See id.

The transfer is intended to separate the assets from risks associated with the originator. The originator will often structure the transfer so that it constitutes a true sale, which is a sale that is sufficient under bankruptcy and commercial law to remove the assets from the originator's bankruptcy estate. Therefore, special consideration must be given to ensure that the transferred assets are protected from the claims of the creditors of the originator. Instead of structuring the securitization transaction through a sale, the parties may structure the securitization through a secured loan, thus reducing the transaction costs. In such cases, however, the transaction documents must ensure that the loan forwarded by the SPV is adequately secured. The loan advanced by the SPV must be secured by a charge on the receivables, so that the SPV becomes a secured creditor of the originator. Further, the SPV must ensure that local law permits the SPV, as an interested creditor, to enforce its charge against the receivables in the event of bankruptcy by the originator. Under the bankruptcy laws of the United Kingdom and most other jurisdictions, secured creditors of a company approaching insolvency can appoint a receiver to control and manage the company purely for the creditors' benefit, thereby satisfying the debt owed to the secured creditor. The priority granted to secured creditors to appoint an administrative receiver is respected in these jurisdictions, whereas priority is routinely violated in other countries. In many jurisdictions, however, the SPV has a security trustee who acts on behalf of the investors. Should the originator become bankrupt, the trustee has extensive powers. In exercise of such powers, the trustee may consider and implement

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14 Dvorak, supra note 3, at 560 ("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.").
15 See Peter Pantaleo et al., Rethinking the Role of Recourse in the Sale of Financial Assets, 52 BUS. LAW. 159 (1996) (analyzing whether particular securitization transactions should be viewed as loans or sales).
16 The parties can save the significant transaction costs of implementing a two-tier sale structure, which is often necessary in a sale context to enable the originator to recoup the residual value of the transferred receivables, once the SPV's investors are paid in full. See Schwarcz, The Alchemy of Asset Securitization, supra note 10, at 141-42.
17 See SCHWARCZ, supra note 3.
18 Id.
19 Id.
20 See, e.g., Insolvency Act, 1986, c. 45, § 32 (Eng.).
23 See Hill, supra note 7, at 1097-98 (discussing the role of security trustees).
24 Id. (discussing the role of trustees in securitization).
alternate uses for the company's assets. Strategies to explore those uses are included in the transaction documents.\textsuperscript{25}

An SPV must be organized in such a way that the likelihood of bankruptcy is remote.\textsuperscript{26} This is because the interest of the prospective buyers for the securities issued by the SPV is a function of the degree to which the SPV is bankruptcy proof and sheltered from the demands of the originator's creditors, in the event that the originator becomes bankrupt.\textsuperscript{27} The SPV should be a legal entity distinct and independent from the originator. This prevents creditors of the originator from having claims against the SPV that enables creditors to file an involuntary bankruptcy\textsuperscript{28} petition against the SPV. Therefore, the SPV must observe all appropriate third-party formalities with the originator. These additional steps help to reduce the risk that the originator, if bankrupt, will either cause the SPV to voluntarily file for bankruptcy or persuade a bankruptcy court to substantively consolidate the assets and liabilities of the SPV with those of the originator.\textsuperscript{29} In conclusion, the foregoing safeguards ensure that the transfer of receivables is better protected against conflicting interests of third parties in the event the securitization transaction is structured through a sale. Where the securitization transaction is structured through a secured loan between the SPV (as creditor) and the originator (as borrower), the rights of the SPV are better

\textsuperscript{25} See generally Benedict Pfister, Special Report: Whole Business Securitizations: A Unique Opportunity for UK Assets, MOODY'S INVESTORS SERVICE, Oct. 19, 2000. Pfister discusses the use of assets in a different capacity—such as converting nursing homes into residential properties—that allows a de-linkage between the securitized debt/bonds and the borrower's industry or business, and may result in a more highly rated issue. See id. In other words, by putting the assets that secure the debt to a new use that is either less risky or more profitable than the previous use, the debt that is secured by these assets receives a higher rating. Because the assets are no longer involved in the borrower's business, the debt is said to be de-linked from the borrower's business.

\textsuperscript{26} See Dvorak, supra note 3, at 548 (noting that the SPV must be bankruptcy remote).

\textsuperscript{27} Cf. id. at 560. Dvorak notes that:

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.

\textsuperscript{28} Although the laws regulating involuntary bankruptcy vary from country to country, most countries accept the principle of companies establishing a separate legal entity distinct and independent from the originator. See, e.g., Yannons Chartered Accountants, Business Start-up, at http://www.workbox.demon.co.uk/C2.htm (last visited Feb. 10, 2005).

\textsuperscript{29} See Schwarcz, The Alchemy of Asset Securitization, supra note 10 (discussing substantive consolidation).
protected. This is because the assets of the SPV are not consolidated with the originator in the event of bankruptcy proceedings. After the assets or receivables are transferred to the SPV, the SPV will issue securities, usually debt or debt-like instruments, to raise funds. The funds generated by the SPV, through the issuance of securities, are transferred to the company as consideration for the sale of the receivables when the securitization is structured through a sale. The funds generated by the SPV will be transferred as consideration for a loan if the securitization is structured through a secured loan. In the event that the securitization transaction is structured through a sale, these securities are redeemable from collections on the receivables purchased by the SPV. If the securitization transaction is structured through a secured loan, these securities are redeemable from the repayment of the loan by the originator. Should the originator default on repayment of the loan, the SPV would enforce its charge on the receivables and the securities would be redeemed from collections on the receivables. As a result, potential buyers of the securities should look to the cash flow from the purchased receivables and not necessarily to the credit of the originator for repayment. The risk that these payments may not be made on time is an important factor in valuing the receivables and a potential buyer must seek to evaluate the aggregate rate of default. Therefore, statistically, a large pool of receivables due from many obligors, for which payment is reasonably predictable, is generally preferable to a pool of a smaller number of receivables due from a few obligors.

C. Advantages of Securitization

1. Economic Generation of Funds

Transferring receivables to the SPV enables the originator to separate these assets from their corresponding liabilities. The originator is able to raise funds at a lower cost through securities issued by the SPV, as compared

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30 Id.
32 See SCHWARCZ, supra note 3.
33 Id.
34 Id.
35 Id.
36 See Dvorak, supra note 3, at 546-47 (discussing the general process of securitization and the transfer of assets from the originator to the SPV).
to raising funds by issuing securities directly.\textsuperscript{37} For example, the securities issued by the SPV may have a higher investment rating than securities issued directly by the originator. This causes the securities to bear a lower interest rate than securities or secured borrowings would obtain on their own. In addition, the offsetting liability will be carried on the SPV's balance sheet rather than on the originator's balance sheet.\textsuperscript{38} From the standpoint of the originator, the cash represents proceeds of the sale of receivables to the SPV or loan forwarded from the SPV, whichever the case may be.

2. FACILITATES COMPLIANCE OF CAPITAL-ADEQUACY GUIDELINES

If the originator is a bank or similar financial institution, the originator may be required to maintain risk-based capital under the Capital Adequacy Guidelines.\textsuperscript{39} Thus, the sale of receivables to an SPV, such as loans reflected as assets on a bank's financial statements, would lower the amount of capital that must be maintained under these guidelines and reduce the bank's effective cost of funds.\textsuperscript{40}

3. COMPLIANCE WITH RESTRICTIONS RELATING TO QUANTUM OF DEBT RESTRICTIONS

An originator may be restricted by its indenture covenants from incurring or securing debt beyond a specified level.\textsuperscript{41} As such, securitization through the sale of receivables would enable the originator to raise funds in compliance with such covenants because the originator sells the receivables and does so without incurring debt; the debt is incurred by the SPV.\textsuperscript{42}

\textsuperscript{37} See id. at 547-48 (observing that through securitization funds can be generated at lower costs).
\textsuperscript{38} See id. at 549 (discussing treatment of the transfer of receivables in the accounts of the SPV and the originator).
\textsuperscript{39} See Capital Adequacy Guidelines for Bank Holding Companies and State Member Banks: Leverage Measure, 12 C.F.R. § 225 (2002).
\textsuperscript{40} See Dvorak, supra note 3, at 549.
\textsuperscript{41} Note that this envisages a situation where the originator would be controlled from incurring unlimited debt (or debt which would negatively impact the creditors) by a covenant in a contract.
\textsuperscript{42} The debt would be reflected in the financial statement of the SPV and not the originator. See Dvorak, supra note 3, at 547-49.
III. Transnational Perspective to Securitization

A. Introduction

International securitization implies a securitization process in which portions of the process are conducted in a foreign country. Here the SPV is established in a foreign country, where securities are issued to generate funds from the foreign community. In the recent past, there has been substantial movement towards internationalization of securitization, and the world has witnessed a boost in cross-border securitization transactions. This is predominantly because many countries do not have a developed capital market. Accordingly, companies located in such countries have limited access to established capital markets such as those found in New York, London, Hong Kong, and other major financial centers.

Recognizing that a growing segment of the world’s money is now locked into receivables, and realizing the possibilities for economic growth by unleashing that wealth, the United Nations Commission on International Trade Law (“UNCITRAL”) has undertaken a project to simplify cross-border receivables financing and to reduce its cost. To that end, UNCITRAL has drafted the Convention on the Assignment of Receivables in International Trade (“UNCITRAL Convention”). The UNCITRAL Convention deals exclusively with the assignment of receivables and specifically avoids involvement in any other part of the financing contract. In other words, the UNCITRAL Convention does not deal with the contract between the originator and the obligors, nor does the UNCITRAL

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43 See generally Theodor Baums, Asset Securitization in Europe (Forum Internationale 1995), http://www.jura.uni-frankfurt.de/ifawz1/baums/Bilder_und_Daten/Arbeitspapiere/a0294.pdf (last visited Feb. 18, 2005) [hereinafter Baums] (discussing securitization in different countries and international securitization where SPVs will be established in foreign countries).

44 Id., http://www.jura.uni-frankfurt.de/ifawz1/baums/Bilder_und_Daten/Arbeitspapiere/a0294.pdf at 5-8 (noting the increased trend in international securitization).

45 See Dvorak, supra note 3, at 552.


Convention deal with any financing documents related to the issuance of securities by the SPV.

Cross-border securitization is a complex process and involves multiple legal systems with unfamiliar terms and unfamiliar rules. Furthermore, the dynamic and fast changing domain of securitization causes difficulty when trying to attain a firm grasp in the securitization process. A firm dealing in international securitization should familiarize itself with relevant local laws in order to grasp the fundamental legal principles of cross-border finance. This enables the firm to ask appropriate questions to foreign counsel and better understand the responses and any resulting implications.

B. International Securitization

There is a need to establish the SPV in the foreign market where the SPV intends to issue securities because the capital markets of some foreign countries may be more established and might provide a better source of finance.50 International securitization, also known as cross-border securitization, enables the company to generate funds at a lower cost from capital markets in foreign countries.51 These benefits have resulted in an unprecedented growth in cross-border securitization, making it a global phenomenon.52

1. DETERMINATION OF THE JURISDICTIONAL FRAMEWORK

There are two key steps to consider in structuring any cross-border securitization. The first step is to determine the transaction’s jurisdictional framework.53 This includes the jurisdictions of the company seeking financing as well as the source of that financing. For example, an Italian company seeking to raise funds from Italian capital markets is not engaged in a cross-border financing, and in such case Italian local law applies. However, when an Italian company wants to use securitization to obtain funding from American capital markets, the company is engaged in a cross-border financing. This requires examination of the laws of the jurisdictions whose

50 See Baums, supra note 43, http://www.jura.uni-frankfurt.de/ifawz1/baums/Bilder_und_Daten/Arbeitspapiere/a0294.pdf
51 See Dvorak, supra note 3, at 548-50 (stating that securitization enables fund generation at a lower costs).
53 See Dvorak, supra note 3, at 552-53 (stating that parties to securitization chose governing law and jurisdiction from across the globe after considering various factors).
borders have been crossed and the manner in which the laws of such
jurisdictions work together with the company's home jurisdiction.

The designers of cross-border securitization transactions search globally
for countries where they can raise funds through securitization.54 There are
numerous factors that govern this search, such as strict restrictive regulations
for protection of investors, the tax implications in that country, the amenities
that the country offers, political stability, the number of institutional in-
vestors domiciled in the country, and the country's socio-economic status.55
As to the latter consideration, for example, a country's laws and socio-economic
conditions may be optimal for the purpose of one objective of the trans-
action, while not catering to other objectives. The same principle is true for
the remaining considerations. For instance, capital markets in the United
States are a significant source of securitization financing because the markets
have a broad investor base and efficient pricing.56 Nevertheless, the issuance
of securities in United States capital markets may require compliance with
United States securities law, which demands extensive disclosure if the
securities are issued without restriction on trading—otherwise known as
public offerings.57 In comparison, some of the European capital markets
may have less compliance cost and more flexibility, but a more limited
investor base.58

54 See id. at 553-54 (discussing various factors that parties consider before opting for a jurisdic-
tion).
55 See Cecile Gutscher, Commercial Banks Flock to Ireland Seeking Tax Breaks, WALL ST. J. EUR.,
Jan. 15, 1997, at 19 (describing the characteristics of Ireland that are favorable to securitization—
including the absence of tax on dividends, interest income, capital gains, low corporate tax rate, and the
avoidance of onerous withholding taxes, which occurs as a result of the double tax treaty network Ireland
enjoys with the United States and its European neighbors).
56 Whether capital markets are efficient has been the subject of some debate. This debate
revolves around the so-called "efficient market hypothesis." See JAMES D. COX, ET AL., SECURITIES
57 The United States has a complex regulatory framework for issuing and dealing with securities.
This framework is based on the Securities Act of 1933, 15 U.S.C. § 77(a) (2000), and the Securities
Exchange Act of 1934, 15 U.S.C. § 78(a) (2000). Also, foreign countries have other regulatory frame-
works. See, e.g., Giovanni Nardulli & Antonio Segni, EU Cross-Border Securities Offerings: An Overview,
Legal Climate, 13 DICK J. INT'L L. 513 (1995); Joel P. Trachtman, Unilateralism, Bilateralism, Regionalism,
Multilateralism, and Functionalism: A Comparison with Reference to Securities Regulation, 4 TRANSNAT'L L.
& CONTEMP. PROBS. 69 (1994); Manning G. Warren III, The European Union's Investment Services Directive,
15 U. PA. J. INT'L BUS. L. 181 (1994); Samuel Wolff, Recent Developments in International Securities Regu-
2. ASCERTAINING THE LAW APPLICABLE TO CROSS-BORDER SECURITIZATION

The second step is ascertaining the law applicable to the cross-border securitization. Since the fundamental feature of international securitization is that different processes of securitization are performed in different countries or different jurisdictions, ascertaining which law applies to the cross-border securitization is necessary. Like other international transactions, the contracts and documents pertaining to the international securitization govern the conduct of the parties involved and constitute the private international law regulating the transaction. Thus, the general terms and conditions of the cross-border securitization are regulated by the legal documents involved and the processes are subject to the laws of the country in which they occur.

In this context, considerable harmonization of laws relating to securitization in various countries is relevant. For example, there are similarities in the laws regulating the transfer of financial assets to the SPV and bankruptcy laws applicable to the transferor of the financial assets. This harmonization of laws is very conducive to the process of international securitization.

IV. INTERNATIONAL SECURITIZATION LAW

A. The Creation of International Securitization Law

Professionals, such as investment bankers and lawyers, have a crucial impact in the development of international securitization law. Frequently, lawyers draft the documents and contracts involved in a cross-border securitization transaction, which (1) provide guidelines to reference and (2) constitute a private law between them. Therefore, international securitization law is created by the lawyers who develop these private contracts. Hence, an accurate name and description of cross-border securitization law-making is lex juris—a law that is developed and established by the lawyers who structure these international securitization transactions. Such laws may also be known as lawyer-made laws ("LML"). Lawyers determine most of these terms and legal frameworks, as well as the laws governing the transactions and the locations in which the various components of the transaction will be performed. This leads to the conclusion that international securitization law is created through contracts and belongs to the genre of LML.

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59 See Dvorak, supra note 3 (discussing provisions of bankruptcy laws of several European countries).
B. The System of Lawyer-Made Laws

Studying the system created by LML plays an important role in understanding the growth of international securitization law. In civil law countries, courts give great weight to interpretative opinions of scholars and the academic commentaries. These opinions have an extremely persuasive effect on the law of the country, which in turn helps to achieve standardization.

The law-making process through private contracts, *lex juris* or LML, has been analogized to *lex mercatoria*—law created by merchants in dealing with each other—as well as to the rules created by their institutions, such as guilds. There are, however, significant distinctions between the two. The institutions in which lawyers are organized, and which produce unified products, are not entirely similar to those of merchants’ trade organizations. Generally, lawyers’ institutions forge stronger ties among members because lawyers who are expelled from these institutions are often times expelled from their professions as well. Some trade organizations may exercise similar powers over their members. However, many trade organizations do not exercise these powers, and members who wish to follow their own lonely path may do so. Thus, the nature and origin of LML are distinct from *lex mercatoria*.

Other LML consist of the legal documents that lawyers draft, such as partnership agreements, trust instruments, and constitutional documents for organizations. As mentioned earlier, these documents become the law for the parties. With passage of time, these contracts between various parties become standardized, forming a system of private law making.

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65 See David F. Cavers, *Legal Education and Lawyer-Made Law*, 54 W. Va. L. Rev. 177, 179 (1952) (listing examples of “laws that the lawyer writes”).
C. Benefits Accruing from the System of Lawyer-Made Laws

There are various advantages in the law-making process that have fostered the growth of international securitization laws. Some of the advantages are detailed below.

1. Benefits of Lawyer-Made Laws Lead to Standardization

Standardization facilitates the development of markets by reducing information costs and risks, as well as offering predictability. Recognizing the benefits of standardization, many industries have developed standardized contracts and procedures that also extend to securitization transactions.

The practice of following precedent and path dependence are also forms of efficient standardization. In the United States, while law firms create innovative and unique contracts, the firms frequently adhere, with minor revisions, to forms they have previously created. Standardized contracts and other legal documents have developed in various spheres and are contained in numerous publications, websites, and other databases. By allowing easy access to accurate information on domestic laws all over the globe, these databases enhance uniformity of cross-border securitization.

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66 See, e.g., Lucian Arye Bebchuk & Andrew T. Guzman, An Economic Analysis of Transnational Bankruptcies, 42 J. L. & ECON. 775 (1999) (arguing that a universal bankruptcy law is more efficient than numerous country-specific laws).
68 See Thomas W. Merrill & Henry E. Smith, Optimal Standardization in the Law of Property: The Numerus Clausus Principle, 110 YALE L.J. 1, 3-4 (noting benefits of standardization are recognized in both common and civil law countries).
71 See Gilson, supra note 69, at 257-58 (citing James C. Freund, ANATOMY OF A MERGER: STRATEGIES AND TECHNIQUES FOR NEGOTIATING CORPORATE ACQUISITIONS 140-41 (1975)) (noting that firms create and urge use of in-house form files).
72 Websites such as www.speedlegal.com have standard drafts, precedents, and templates that reduce the amount of time needed to create documents. Furthermore, websites such as www.lexisnexis.com and www.manupatra.com have databases of laws for many jurisdictions.
73 Some databases also provide advisory services, such as standardized contracts and documents. See, e.g., CCH, Inc., Global Capital Markets Internet Library, at http://onlinestore.cch.com/default.asp?ProductID=1655 (last visited Feb. 10, 2005). Such documents are not currently available in the securitization area; however, they may become available with time.
2. CREATION OF EFFICIENT CONTRACTS

Standardization helps both lawyers and their clients in converting contracts into a reproducible form. These standardized contract forms can be adjusted when the laws change and can be kept up-to-date at minimal expense. A standard form that has weathered attacks, especially when revised in reaction to judicial decisions, is arguably more reliable and predictable than a new form. These established, highly reliable forms then enable lawyers to predict the results of the contractual arrangements should conflicts arise between the parties. Thus, even in an area where customized arrangements are presumed to be the rule, lawyers can standardize and unify the rules that govern the parties' behavior.

V. CONSIDERATIONS AND ISSUES INVOLVED IN A CROSS-BORDER SECURITIZATION TRANSACTION

There are various considerations and issues that are involved in a typical cross-border securitization transaction. Since the various processes of securitization are subject to the laws of the country in which they occur, ensuring that there is compliance with applicable local law is necessary. These issues are discussed below.

A. Commercial Finance Issues

The securitization agreement must secure the interests of the SPV and safeguard its assets from the claims of the originator and the originator's creditors. In this context, various legal considerations must be addressed to determine how the SPV and its investors stand against the originator's creditors: whether the securitization transaction is potentially preferential or fraudulent, and whether other legal impediments exist to prevent securing the interests of the SPV.

1. PERFECTION AND PRIORITY

The term "[p]erfection refers to the protection of a transferee's interest in transferred assets from creditors of the transferor and from the trans-

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74 The websites referred to in supra notes 72 and 73 are frequently updated and revised as per applicable law and judgments of the court. Therefore, the standardized contracts are upgraded per judgments of the courts.

75 See supra Parts II.A-B.
In a securitization transaction, perfection means protecting the SPV's interest in the transferred receivables from claims of the originator's creditors and all other conflicting interests. Due to the fact that receivables are intangible and therefore not physically located in any particular jurisdiction, the law of the originator's jurisdiction usually governs perfection.77

There are different modes in which the transferee's interest is perfected in different jurisdictions. Some jurisdictions have a filing or other public notice system for perfection,78 while other legal systems may require notification to obligors, which may be expensive.79 Often, the local perfection procedures may be unclear or impractical, in which case investors are forced to rely on the originator's representations, warranties, and covenants that the receivables transferred to the SPV are unencumbered. This illustrates the need for a uniform perfection regulatory system at a global level.80

The term priority is defined as the "ranking of multiple claims against a transferred asset."81 In the securitization context, however, priority means that the claims of the SPV on the transferred receivables should be made

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77 Under the UNCITRAL Convention, the location of the assignor would govern. See Bazinas, Multi-Jurisdictional Receivables Financing, supra note 48, at 380-81; accord U.C.C. § 9-103(3)(b) (2000). However, this is not a universal rule. For example, some jurisdictions may look to the law of the receivable, the meaning of the law of the contract under which the receivable arose, or the law of the jurisdiction where the obligor is located. See generally Permanent Bureau of the Hague Conference on Private International Law, Note on The Law Applicable to Receivables Financing (March 2000), http://hcch-evision.nl/upload/wop/gen_pd3e.pdf (last visited Feb. 18, 2005). Except to the extent large concentrations of obligors are located in a given jurisdiction, it may be impractical to consult local counsel in each obligor's jurisdiction.

78 The purpose of filing is to place third parties on notice of the transfer of the asset. In the United States, this is usually done by filing a Form U.C.C.-1 financing statement. UNCITRAL has proposed a registration system for this purpose. See Schwarz, The Alchemy of Asset Securitization, supra note 10, at 139.

79 Besides the obvious costs involved in notifying all the obligors (which includes trade receivables), notification may also be seen as a signal that the company is in financial difficulties. "This is a problem practitioners often run into . . . [b]ut it is a problem that is not documented in the literature." STANDARD & POOR'S, STRUCTURED FINANCE RATINGS ASSET BACKED SECURITIES: TRADE RECEIVABLE CRITERIA 21-30 (1996).

80 See Schwarz, The Alchemy of Asset Securitization, supra note 10, at 153 (analyzing the potential benefits of implementing a uniform perfection system for securitization and other forms of cross-border receivables financing).

81 See Schwarz, Symposium: The Impact on Securitization, supra note 76, at 956 (discussing the concept of priority).
superior to any third-party claims.\(^{82}\) In most jurisdictions, priority is established by the chronological sequence in which the filing required for perfection has been completed.\(^{83}\) If the originator is located in a jurisdiction that does not have a filing requirement or other registration system to indicate priority, the investors may have to rely on the originator's representations, warranties, and covenants—creating a much greater risk of fraud than in jurisdictions that use public filing systems.\(^{84}\)

In some cases, the securitization may involve the transfer of receivables that will be created at a future date;\(^{85}\) therefore, it is prudent to ask whether local laws permit this type of transaction.\(^{86}\) Absent a system that makes transfers of receivables publicly ascertainable, securitization is discouraged because an SPV will not be able to determine its priority at the time of the transfer.\(^{87}\) UNCITRAL's Convention proposes an optional centralized registration system that could be used to provide such notice. For states opting in, this form of centralized registration would provide that:

between assignees of the same receivable from the same assignor, the priority of the right of an assignee in the assigned receivable is determined by the order in which data about the assignment are registered [under a centralized registration system established by the Convention], regardless of the time of transfer of the receivable.\(^{88}\)

\(^{82}\) See Schwarcz, supra note 3.

\(^{83}\) Priority is sometimes colloquially defined as first in time, first in right. Generally, this definition gives priority to the first person to file against the asset. Priority is ascertained by searching the relevant records to determine whether other parties have prior filings against the relevant assets. See, e.g., U.C.C. § 9-312(5)(a) (2000).

\(^{84}\) See Dvorak, supra note 3, at 558 (discussing the importance of a public filing system and the implications of such a system).

\(^{85}\) For example, certain cross-border financings are supported by payments to be made in the future under international telephone contracts. Private placement by the Mexican telephone company Teléfonos de México, S.A. (sometimes referred to as "TelMex") are illustrative of such a phenomenon. See generally Claire A. Hill, Latin American Securitization: The Case of the Disappearing Political Risk, 38 Va. J. Int'l L. 293 (1998) (providing more information on this transaction).

\(^{86}\) Note that the UNCITRAL Convention allows for the transfer of receivables that will be created at a future date. See Bazinas, An International Legal Regime, supra note 46, at 329. See also Steven L. Schwartz, The Parts Are Greater Than the Whole: How Securitization of Divisible Interests Can Revolutionize Structured Finance and Open the Capital Markets to Middle-Market Companies, 1993 COLUM. BUS. L. REV. 139, 149 n.36 (examining the law on selling future payments under a contract not yet in existence).

\(^{87}\) See Schwartz, Symposium: The Impact on Securitization, supra note 76, at 956.

\(^{88}\) UNCITRAL Convention, supra note 48, at § 1, art. 1. See also UNCITRAL Convention, supra note 48, at art. 42 (implementing optional registration).
2. COMMINGLING

Another risk is that cash received on account of the receivables, the money which is realized when the receivables mature, may be mixed or commingled with the originator's own funds. In situations where the originator is freely permitted to use collections realized from maturity of the receivables, a court may find the originator's control inconsistent with the SPV's claim that it has a perfected interest in the collections. Local tracing laws may ameliorate this risk to an extent.\(^8\) Commingling may also be prevented by using lockboxes\(^9\) or by segregating cash flows.\(^9\) If these approaches are not available, one should ascertain whether proceeds are traceable and ask local counsel whether traced proceeds are protected.

Under the UNCITRAL Convention, the risk of commingling is minimized.\(^9\) Per the UNCITRAL Convention, if upon maturity of the receivables, the proceeds are received by the originator, then the SPV will have a priority over the right of any other party, if either of the following conditions are satisfied: (1) the originator has received them under instructions from the SPV to hold the proceeds so received for its benefit,\(^9\) or (2) the proceeds are held by the originator for the benefit of the SPV separately and are reasonably identifiable from the assets of the originator.\(^9\)


\(^{9}\) A lockbox is a banking collection service which uses a unique post office box. See Linda T. Patterson, A Management View of Cash Management, as published by the INTERNATIONAL CITY MANAGER'S ASSOCIATION 2/96 MIS REPORT (Feb. 1996), http://www.patterson.net/arti-003.shtml (last visited Oct. 1, 2004).

\(^{91}\) Segregating cash flows means that the funds are kept separately and operated separately. It is obvious that segregating cash flow would result in an absence of commingling.

\(^{92}\) Article 14.1(b) of the UNCITRAL Convention, supra note 48, states that “[i]f payment in respect of the assigned receivable is made to the assignor, the assignee is entitled to payment of the proceeds.” Article 24.2 provides that:

[i]f proceeds are received by the assignor, the right of the assignee in those proceeds has priority over the right of a competing claimant in those proceeds . . . if: (a) the assignor has received the proceeds under instructions from the assignee to hold the proceeds for the benefit of the assignee; and (b) the proceeds are held by the assignor for the benefit of the assignee separately and are reasonably identifiable from the assets of the assignor, such as in the case of a separate deposit or securities account containing only proceeds consisting of cash securities.

Id. at art. 24.2.

\(^{93}\) See id.

\(^{94}\) See id.
3. PREFERENTIAL AND FRAUDULENT TRANSFERS

The bankruptcy laws of some jurisdictions may permit or require a bankrupt company or its representative to avoid transfers of assets or obligations incurred by the company prior to its bankruptcy. Some of these laws are referred to as preference laws, because they avoid preferential transfers. These laws are intended to ensure equality of distribution of the company’s assets among all of its creditors. The laws of some jurisdictions may also provide that transfers made or obligations incurred by a troubled company for less than equivalent value be deemed fraudulent and, therefore, voidable. Thus, in securitization transactions, the transfer of receivables from the originator to the SPV should be at arm’s length, and the laws relating to preferential and fraudulent transfers in the jurisdiction of the originator should be thoroughly reviewed.

The UNCITRAL Convention does not cover these issues directly, but the document does generally specify which law or jurisdiction governs preferential transfers. For instance, Article 30 provides that in an insolvency proceeding initiated in a country other than the country where the assignor (i.e., the originator) is located, any preferential right that arises by operation of law and that has priority over the rights of the assignee (i.e., the SPV) continues to enjoy such priority.

B. Contractual and Legal Restrictions

The next issue is whether there are any contractual or legal restrictions affecting the financing. There are two main ways in which contractual restrictions can arise. First, there may be restrictions that limit origination of receivables, such as anti-assignment clauses. For example, a lease may prohibit the lessor from assigning the rights to lease payments. Some jurisdictions do not permit the assignment of receivables, and, consequently, the local law must be examined.

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95 For example, the United States limits preferential transfers made within ninety days of the company’s bankruptcy. 11 U.S.C. § 547 (2000). If the transferee is an insider, the limit is extended to one year. Id.
96 See id.
97 See id.
99 See UNCITRAL Convention, supra note 48, at arts. 22, 23.3, and 30.3.
100 Id. at art. 30.
101 See Martin Fingerhut et al., Developments in Canadian Securitization, 14 INT’L BANKING & FIN. LAW 120 (1996).
102 See U.C.C. § 9-406 (2000); Bazinas, Multi-Jurisdictional Receivables Financing, supra note 48, at
While the UNCITRAL Convention permits certain assignments, notwithstanding anti-assignment clauses, the document still protects obligors who would be harmed by the assignment by making the assignor liable for breach of the prohibition. The UNCITRAL Convention protects obligors by clarifying that the assignment of receivables does not increase their burden, and provides that the rights and obligations of the obligor or debtor are not altered without the consent of the debtor. While permitting a change in the payment instruction (with reference to the person, address, or account) in which the payment must be made, the UNCITRAL Convention does not allow any change in the currency or country in which the payment must be made.

Second, contractual restrictions may also arise through negative pledge or similar covenants contained in contracts previously entered into by the originator, such as previously existing financing documents of the originator that may limit the creation of secured debt. In these cases, financings must be restructured to get around the restrictive covenant. Tackling such negative covenants requires a proper understanding of the covenant as well as its interpretation in law. For example, would a covenant restricting a

372. The implicit rationale for nullifying restrictions on the assignment of receivables might be that the obligor on the receivable is not prejudiced by its assignment, whereas enforcing an anti-assignment clause would impair the free alienability of property rights. A receivable represents the originator's right to payment, and property, after all, is merely a bundle of rights.

103 Article 9.1 of the UNCITRAL Convention provides that "[a]n assignment of a receivable is effective notwithstanding any agreement between the . . . assignor and the debtor [i.e., the obligor on receivables] . . . limiting in any way the assignor's right to assign its receivables." UNCITRAL Convention, supra note 48, at art. 9.1. Article 9, however, only applies to the types of receivables listed in subsection 3. Id. at art. 9.3.

104 Article 9.2 of the UNCITRAL Convention provides that "[n]othing in this article affects any obligation or liability of the assignor for breach of such an agreement . . . ." Id. at art. 9.2. The assignee, however, is not necessarily liable to the debtor for such a breach: "A person who is not party to such an agreement is not liable on the sole ground that it had knowledge of the agreement." Id.

105 Thus, Article 15.1 of the UNCITRAL Convention provides that "assignment does not, without the consent of the debtor [i.e., the obligor on the receivables], affect the rights and obligations of the debtor, including the payment terms contained in the original contract." Id. at art. 15.1.

106 See id. at art. 15.

107 Typically, these financing documents were put into place for other financings, not the financing being structured. For example, negative pledge clauses prohibit or limit the creation of secured debt. See generally Thomas C. Mitchell, The Negative Pledge Clause and the Classification of Financing Devices: A Question of Perspective, First Installment, 60 AM. BANKR. L.J. 153 (1986) [hereinafter Mitchell, The Negative Pledge Clause] (discussing negative pledge clauses); Thomas C. Mitchell, The Negative Pledge Clause and the Classification of Financing Devices: A Question of Perspective, Second Installment, 60 AM. BANKR. L.J. 263 (1986) [hereinafter Mitchell, The Negative Pledge Clause . . . , Second Installment] (discussing negative pledge clauses).

secured loan also restrict a sale? The answer can be ambiguous if, under the governing law, the line between a sale and a secured loan is unclear. Furthermore, ascertaining the applicable governing law for this purpose is sometimes difficult. For instance, the covenant may be contained in a financing document governed by English law, but the covenant may prohibit liens on assets of a company located in Mexico.

Finally, with reference to the legal restrictions, one should inquire with local counsel as to whether the local law itself restricts the financing in any fashion, and whether the securitization transaction complies with all local regulatory and legal requirements. There can be local restrictions that arise in any securitization contract.

C. Enforcement Issues

In an international and commercial context, having theoretical rights under the law is not enough. The critical question is whether one can enforce those rights, recognizing that the legal system granting the rights may not be the same as the one in which enforcement occurs. Furthermore, foreigners may not be viewed favorably when enforcing rights against local citizens. Therefore, the investors may require the originator to submit to the jurisdiction of the country in which the investors reside or at least submit to the jurisdiction of the country where the SPV is located. This choice of law requirement is advantageous to investors for both procedural reasons and forum convenience. Additionally, the investors would not face any bias against foreigners in the originator’s judicial system. The investors can simply sue in the jurisdiction to which the originator has submitted, obtain a judgment, and take the judgment to the originator’s home jurisdiction to be enforced against the assets of the originator. Counsel in the originator’s home jurisdiction should be consulted in advance, however, to verify that such a judgment would be legally recognized and enforced, as well as what defenses may be raised against such enforcement. Furthermore, submitting to a particular jurisdiction could require the originator to appoint a process agent in the jurisdiction to accept service of process.

While arbitral awards are governed by the U.N. Convention for the Recognition and Enforcement of Foreign Arbitral Awards, no such treaty exists for the enforcement of foreign judgments. Countries often recognize foreign judgments on the basis of reciprocity. In the United States, this varies from state to state; however, several states have adopted the Uniform Foreign Money Recognition Act and the Uniform Enforcement of Foreign Judgments Act. See Christopher P. Hall & David B. Gordon, Enforcement of Foreign Judgments in the United States, 10 INT’L LAW PRACTICUM 57 (1997); Shirley Sostre-Oquendo, Recognition and Enforcement of Foreign Judgments in the United States and Canada in the Free Trade Era, 1992 DET. C. L. REV. 1019 (1992). In other countries, similar laws exist. See, e.g., INTRODUCTION TO THE LAW AND LEGAL SYSTEM OF KOREA 1152 (Sang Hyun Song, ed. 1983).
Another potential problem is that the originator could be immune from suit under its local law if the originator has sovereign or quasi-sovereign ownership that creates sovereign immunity. In such a case, investors may require the originator to waive such immunity, if feasible. In the United States, for example, such a waiver is enforceable under the United States Foreign Sovereign Immunities Act of 1976. However, this means that United States courts will only respect the waiver of sovereign immunity. Investors must still determine whether such a waiver would be respected in the home jurisdiction of the originator.

D. Foreign Currency Issues: Mitigation of Risks Due to Fluctuation in Foreign Currency Exchange Rates

Currency exchange issues are always pertinent in any cross-border transaction. In cross-border securitization, the problem is that the currency in which investors purchase the SPV’s securities may be different than the currency the SPV receives to repay them. In this context, currency exchange controls and relevant regulations must be considered. There is a risk that the originator’s home jurisdiction may limit the export or private use of U.S. dollars or other relevant foreign currency. This risk is minimized if the originator has significant assets outside the originator’s

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110 Traditionally, sovereign immunity provided absolute protection to the monarch from suits by its subjects. Today, citizens cannot sue the state and its officials unless the state consents. Sovereign immunity was once considered absolute; however, over time certain exemptions have been recognized. See Malcolm N. Shaw, INTERNATIONAL LAW 372-405 (4th ed. 1997). Perhaps the most important exemption under the United States Foreign Sovereign Immunity Act is the commercial activity exemption. See 28 U.S.C. § 1603(d) (1994).


113 This is because the obligors and the investors may be located in different jurisdictions. See supra Part III.

home jurisdiction against which the investors can enforce their claim, or if there are significant offshore obligors on receivables. Enforcement against those assets or obligors will not be subject to the local laws of the originator's country. Furthermore, arranging local currency swaps for U.S. dollars may mitigate the risk due to restrictions on export or private use of foreign currency. One should also inquire whether the originator's home jurisdiction has ever imposed, or is likely to impose, debt moratoria of the type that restricts the originator from paying its debts to foreigners. Furthermore, the investors also have to take the risk of sustaining a loss due to fluctuation in the exchange rates of the currencies involved. For example, suppose investors buy U.S. dollar-denominated securities to enable an SPV to purchase a portfolio of Japanese yen-denominated receivables. When the receivables mature and the payment obligations under them are met, these investors risk repayment if the dollar-to-yen exchange rate yields insufficient dollar amounts. Some of the mechanisms employed to insure against such contingency are discussed below.

The exchange rate risk, which the investors bear, is generally hedged through swaps and other derivative products. To understand how this is achieved, one needs to be familiar with some basic definitions. A derivative product, in its most basic form, is a contract that creates future rights and obligations regarding an asset that underlies a larger transaction. Derivative products can be broken down into forward contracts and options. In an option, one party pays for the right, but not the obligation, to buy an asset

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115 Notably, local currency swaps to United States dollars would avoid such restriction, as remittances of dollars may not be restricted.

116 Debt moratoria have occurred before, for example, in places such as South Africa, the Philippines and Russia. Neil Behrmann, South Africa Hopes to Reschedule Debt as Total Declines, WALL ST. J., June 11, 1993 (South Africa); Julia Leung, Filipinos Plan Again to Issue Overseas Bonds, WALL ST. J., Oct. 30, 1992, at B4 (the Philippines); Terence Roth & Tim Carrington, Moscow Stops Paying Bank Debt Principal, WALL ST. J., Dec. 5, 1991, at A3 (Russia).

117 "Hedging, using the futures market, is the process of neutralizing or significantly reducing financial risks . . . . There are two fundamental reasons for hedging. The first is to reduce risk . . . . The second is the ability to separate the timing decision from market opportunities." Robert W. Hiller, Sources of Financing: Traditional and New, AMA MANAGEMENT HANDBOOK, 25, 32 (John J. Hampton ed., 3d ed. 1994).

118 See, e.g., Joseph L. Motes III, A Primer on the Trade and Regulation of Derivative Instruments, 49 SMU L. REV. 579, 583-84 (1996) [hereinafter Motes]. A great deal of derivative documentation is standardized worldwide through use of so-called ISDA forms developed by the International Swaps and Derivatives Association. These forms are available on the ISDA's website. See ISDA Website, at http://www.isda.org (last visited Sept. 15, 2004).

at a future date for a negotiated price. A forward contract is a contractual obligation to buy or to sell an asset, such as foreign currency, at a specified price at a future settlement date. A swap is an array of forward contracts, which cover each date that settlement is to be made.

Currency hedging is accomplished by entering into a swap with a third-party—known as a swap counter-party—to exchange the relevant currencies at the future settlement dates. The parties agree in the swap contract to the exchange rate that will be deemed to apply on the settlement dates in order to ensure that the currency conversion will yield sufficient dollars to repay investors. For example, if investors make purchases with U.S. dollars, expect to receive payment in Japanese yen, and need an exchange rate of 126 yen per dollar to be fully repaid in dollars, then these investors would need a swap counter-party to protect themselves. The investors would need a swap counter-party who is willing to exchange dollars for yen at that rate on the future settlement date. Thus, if the exchange rate has reached 130 yen per dollar on the settlement date, the investors would be protected because the swap counter-party has assumed the currency exchange risk. Therefore, investors would not be at a loss due to fluctuation in the foreign exchange rates. However, if the exchange rate has fallen to 125 yen per dollar, the swap party profits on the exchange.

Investors will need assurance that the counter-party can perform its swap obligations on each settlement date should the net value of the swap

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122 See Motes, supra note 118, at 590. The actual underlying swapped assets are rarely exchanged. Rather, one party to the swap makes a payment to the other based on the net valuation of the swapped assets on the future settlement date. See JOHN F. MARSHALL & KENNETH R. KAPNER, THE SWAPS MARKET 32 (2d ed. 1993) [hereinafter MARSHALL & KAPNER] (“The underlying assets may or may not be exchanged and are referred to as notionals.”). The assets, for example, could be foreign currencies in the case of currency swaps in cross-border finance transactions, or they could be oil in the case of a swap involving a company that needs oil at a future date and wants to fix the price. Swaps are therefore akin to gambles on future asset values. Indeed, there is ongoing controversy as to whether derivative products can be abused, particularly where investors borrow on leverage to purchase derivative products for speculation. In a non-leveraged context, however, the use of derivatives to hedge currency (or interest rate) risks in cross-border transactions is not only prudent, but essential for minimizing the risk to investors.


run against the counter-party. If there is a risk that the counter-party is unable to perform its swap obligations, the investors should minimize performance risk by requiring the counter-party to collateralize its future obligations or to obtain a third-party guaranty. Requiring the counter-party to make periodic adjustment payments that reflect the changing net value of the swap can also minimize the performance risk. This reduces the risk that the counter-party will be unable to pay the net amount due at a future date. This method of controlling performance risk is referred to as mark-to-market.125

E. Tax Issues

Tax issues in cross-border securitization transactions include those relevant in purely domestic securitization transactions, as well as additional issues that may have to be determined under foreign law depending on the location of the originator, the receivables, and the SPV.

In general, there are three major tax concerns that arise in any securitization transaction. The first is whether the transfer of receivables from the originator to the SPV will be treated for tax purposes as a sale, requiring gain or loss recognition, or as a loan. The second concern is the degree to which the SPV itself will be subject to tax (the so-called entity-level tax). The final concern is the tax treatment of individual investors who purchase these securities. Moreover, a cross-border securitization transaction, raises additional tax issues, which are discussed below.

1. WITHHOLDING TAX

Payments that are treated as interest for income tax purposes may be subject to withholding taxes in the jurisdiction of the payer, and the cost thereof must be factored into the particular transaction.126 The interest payments may take place in a cross-border securitization, in the following cases: (1) if the obligors in one country pay interest on the underlying receivables to an SPV in another country due to sale of receivables, the

125 See Jon Moynihan, Measuring the Risk Adjusted Profitability of Derivative Products on Bank Capital, THE HANDBOOK OF CURRENCY AND INTEREST RATE RISK MANAGEMENT 25-1, 25-9 to 25-11 (Robert J. Schwartz & Clifford W. Smith Jr. eds. 1990) (describing the mark-to-market methodology). Forward contracts that include periodic marking to market are called futures contracts. See also MARSHALL & KAPNER, supra note 122, at 19 (discussing the relationship between mark-to-market and futures).

payments made by the obligors may be subject to withholding tax regulations in the country where the obligors are resident, and, (2) if a transaction between the originator in one country and an SPV in another country is treated as a loan by the tax authorities of the originator’s jurisdiction, there may be withholding taxes on interest paid on the loan. For example, the jurisdiction of the company may attempt to tax interest income of the SPV if the transfer of assets from the company to the SPV is characterized for tax purposes as a loan from the SPV to the company. Since the non-resident SPV may not be directly subject to taxes in the company’s jurisdiction, that jurisdiction may require the company to withhold a portion of the amount of interest otherwise payable and pay the withheld amount to the relevant taxing authority. The final case is where an SPV in one country raises money by issuing debt instruments to investors in another country. Here the interest that would be paid by the SPV on the debt instruments may be subject to withholding tax regulations in the country of the SPV.

Many countries impose a withholding tax on the gross amount of interest paid to certain foreign persons not otherwise engaged in business in the country from which the interest is paid. The amount is withheld by the payer on behalf of the payee and paid over to the appropriate taxing authority. Frequently, this withholding tax is reduced or eliminated pursuant to the applicable terms of a tax treaty between the country of the payee and that of the payer, but this will not always be the case. If the tax is not eliminated, it will be necessary to determine which party will bear its cost. In most cases, this cost will be borne by the payer through indemnity and gross-up provisions in the securitization contract. Under this provision, the payer is required to pay the payee an extra amount in order to compen-

127 To determine whether a transfer will be characterized as a sale or a loan, several factors will be considered. For a list of such factors, see Schwartz, The Alchemy of Asset Securitization, supra note 10, at 45.


131 For any tax paid by the payee, the payer would provide the payee with an indemnity. Indemnity is the sum of money paid in compensation for loss or injury. See, e.g., WordNet Website, Overview for “indemnity,” at http://www.cogsci.princeton.edu/cgi-bin/webwn?stage=1&word=indemnity (last visited Sept. 16, 2004).

132 A gross-up provision, frequently used in cross-border transactions, is defined as a provision where the payer pays additional money to the payee to cover for the tax that would be imposed on the actual amount payable. See Bill Maclagan & Kevin Zimka, Cross-Border Guarantees—Be Careful!, at http://www.blakes.com/english/publications/focus/article.asp?A_ID=310&DB=BlakesReport (last visited Sept. 16, 2004).
sate the payee for the tax withheld. Establishing an SPV in a tax haven jurisdiction or in a jurisdiction with a wide tax treaty network may minimize withholding tax costs.

2. TAXATION OF THE SPECIAL PURPOSE VEHICLE AND ITS SHAREHOLDERS

As noted above, establishing the SPV in a tax haven jurisdiction is desirable. This will both minimize withholding tax on any interest payments made by the SPV and avoid mainstream tax on the net income of the SPV—assuming it is an entity subject to such tax. However, the use of a tax haven can increase the potential withholding tax burden on any interest payments made to the SPV, either by the underlying obligors on the receivables or by the originator. This is due to the fact that tax havens are not typically parties to tax treaties that eliminate withholding taxes.\(^{133}\)

Ensuring that the SPV will not be subject to any mainstream income tax in a jurisdiction where the SPV does not reside is also important. For example, if the SPV owns receivables of obligors in another jurisdiction and the originator services the receivables in that other jurisdiction on behalf of the SPV, the question arises: whether the SPV will be deemed to be doing business or to have a permanent establishment in that jurisdiction? Either finding could subject the SPV to mainstream income tax in that jurisdiction.\(^{134}\) Generally, however, the SPV will not be subjected to such tax if the originator is performing purely ministerial functions and has no power to bind the SPV in any way.\(^{135}\)

3. OTHER CROSS-BORDER TAX ISSUES

Since cross-border securitization involves transactions in different currencies, tax implications relating to a gain or loss caused by exchange rate fluctuation may be raised. Additionally, swaps and hedges may be subject to

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\(^{135}\) See supra note 134.
taxation. Furthermore, in the case of transfers between affiliated companies, pricing regulations for the transfers would also need to be considered.

VI. CONCLUSION

International securitization enables a company to raise funds at lower costs from capital markets in foreign countries. The structuring of an international securitization basically revolves around two issues: first, determining the jurisdictions in which the cross-border securitization operates, and second, ascertaining the applicable law and structuring the securitization in consonance with it.

There are numerous factors—such as restrictive regulations for protection of investors, the relevant tax implications, and the amenities available in that country—that influence the choice of country for raising funds through securitization. Consequently, the whole socio-economic condition of a country should be analyzed before choosing to structure a cross-border securitization.

With respect to the regulation of international securitization transactions, this article concludes that international securitization law governs international securitization. Furthermore, the various processes of securitization are subject to the law of the country where they occur. In this article, examined the creation and nature of international securitization law and discussed the issues involved in securitization that attract municipal law implications. These conclusions are summarized below.

A. Examining the Evolution and Nature of International Securitization Laws

There has been dynamic growth and development of international securitization laws by means of lex juris, much like the development of the law relating to internet transactions. In contrast to the process of creating domestic laws and international treaties, the process of creating lex juris is flexible. The process avoids the procedural and political straightjackets of

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137 See supra Part IV.A.
139 Id.
domestic and international institutions. While *lex juris* rules are flexible, they can be quickly unified into standards and guidelines of sufficient predictability. Uniformity of the laws, rules, and forms is driven by the quest for efficiency, the desire to avoid risk, and the need for order. At the same time, the pattern of achieving these objectives allows for experimentation, creativity, and greater and faster adjustment to changes in the environment.

While the details of *lex juris* rules can be quickly standardized and changed, the norms on which the rules are based are not necessarily shifting and unpredictable. *Lex juris* represents fundamental values that command a consensus. If *lex juris* rules deviate from these fundamental values, domestic law will keep a check on this deviation. This article concludes that *lex juris* is and will continue to be a strong influence in the evolution of international securitization laws; it will emerge as a forerunner in the formulation of international rules that cut across nations to regulate specific global activities.

B. The Issues Involved in a Cross-Border Securitization Transaction

Cross-border securitization can be daunting to the uninitiated, involving multiple legal systems with strange terms and sometimes even stranger rules. The legal issues involved in a securitization transaction are numerous. Firms and lawyers dealing in international securitizations find difficulty in maintaining up to date knowledge of the relevant laws of foreign countries; consequently, consulting local counsel of foreign countries on specific issues proves to be prudent and practical.\(^\text{140}\) This requires basic knowledge of certain fundamental legal principles in order to put forth appropriate questions to local counsel and understand both the response and its implications. Therefore, a firm or lawyer dealing in cross-border securitizations needs to understand the process of securitization and certain fundamental legal principles that are pertinent in a cross-border securitization structure.

As the process of securitization becomes uniform, the issues related to securitization also become uniform. Since the laws addressing these issues vary between countries, the establishment of a universally accepted international code specifically designed to govern these concerns at an international level would greatly facilitate cross-border securitization. The UNCITRAL Convention is a significant step towards harmonizing the laws.

\(^{140}\) Even after seeking appropriate information from local counsel, there is always considerable political risk involved; hence, it is advisable to cover specific risks through political risk insurance, although very expensive. *See* Claire A. Hill, *How Investors React to Political Risk*, 8 DUKE J. COMP. & INT'L L. 283 (1998).
governing international receivables financing, thereby facilitating the growth of cross-border securitization in general.