

# Does factoring require a lending licence?

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## Introduction

In Japan, money lending operations are subject to certain licensing requirements. That said, it is generally understood that a registration under the Money Lending Business Act is not required to purchase existing receivables. Thus, it may be easier for non-Japanese financial institutions to acquire receivables as opposed to making loans using funds from their own accounts. However, a recent Osaka District Court judgment suggests that this may not always be the case. This update briefly explores the judgment and offers certain points to bear in mind when considering acquiring receivables in Japan.

## Money lending requirements

In order to engage in a money lending operation in Japan, financial institutions must comply with certain licensing or registration requirements under the relevant financial regulations, such as the Banking Act and the Money Lending Business Act (for further details please see "[Acquisition of Japanese loans by non-Japanese financial institutions](#)").

In this regard, it may be easier for non-Japanese financial institutions to acquire receivables as opposed to making loans using funds from their own accounts. One possible method for an institution to acquire a Japanese receivables portfolio is to purchase loan receivables from Japanese financial institutions (ie, existing lenders). In this way, the acquiring institution will become the new creditor with regard to the Japanese borrowers that must pay the debts which underlie the receivables.

Alternatively, an institution may purchase account receivables from Japanese companies aiming to increase their liquidity ratio rather than extend further credit to the obligors of the debts which underlie those receivables.

Through either option, the financial institution purchaser will become a creditor to the obligors by acquiring existing receivables. It is generally understood that registration as a money lender (ie, an operator of a money lending business) under the Money Lending Business Act is not required to acquire receivables. However, an Osaka District Court judgment of March 3 2017 implies that this understanding may not always be the case.

## Osaka District Court case

In this case, the plaintiff (a shipping company) sold to the defendant (a company which was operating a factoring business and was not registered as a money lender) two pools of account receivables representing credit extended by the plaintiff to its customers in order to convert such receivables into cash (ie, the consideration paid for the account receivables). These two transfers were perfected to ensure the priority of the defendant's claim over those of any third party, as prescribed under the

law. However, the arrangement between the parties involving the account receivables involved more than just these initial transactions.

Following completion of the initial sale transactions, the plaintiff repurchased the same receivables from the defendant and, in consideration for such receivables, paid the repurchase price amount to the defendant. Thereafter, both parties repeatedly sold and repurchased the same pools of receivables to each other over 13 months and, in each transaction, the purchasing party made a cash payment to the selling party. Through these transactions, the aggregate amount of consideration received by the plaintiff was approximately Y33 million and the aggregate amount of consideration paid by the plaintiff was approximately Y38 million. The purchase and repurchase prices were not necessarily linked to the face value of the transferred receivables and the terms and conditions of these transactions generally required the plaintiff to bear the risk of the obligors' non-payment. In addition, the obligors of the debts which underlied the account receivables were not notified of any of the transfers and, notwithstanding the transfers, the plaintiff continued to collect the obligors' payments in satisfaction of the debts underlying those receivables. The cash collected by the plaintiff as payments from such obligors was partly used to pay the repurchase prices under the sale of receivables transactions.

### **Plaintiff's allegations**

The plaintiff alleged, among other things, that the series of transactions between it and the defendant should be characterised as loan transactions secured by the account receivables and thus be subject to the Interest Rate Restriction Act (which sets maximum interest rates for loan transactions).

Further, according to the plaintiff:

- the difference between the amount that the plaintiff had paid to the defendant and the amount that the plaintiff had received from the defendant constituted interest under these alleged loan transactions; and
- the defendant was obliged to return any amount of interest that exceeded the maximum amount permitted under the Interest Rate Restriction Act.

### **Decision**

The Osaka District Court agreed with the plaintiff's contentions and recognised the transactions as a lending arrangement between the parties, even though the relevant agreements between them were identified as receivables sales agreements. According to the court, a lender can earn interest only at or below the maximum interest rate prescribed under the Interest Rate Restriction Act, while a purchaser of receivables may receive a greater amount through an acquisition of receivables transaction. However, the court focused on the particulars of this transaction, such as the fact that:

- in general, the plaintiff, as seller, had assumed the risk of non-payment by the obligors as opposed to the defendant, as purchaser;
- the profits earned by the defendant were exclusively the difference in the purchase and repurchase prices paid to and received from the seller through these transactions; and
- the purchase and repurchase price amounts paid in these transactions were not necessarily linked to the face value of the receivables in the transferred pools.

In light of the above, the court determined that the transactions in question should be characterised as lending transactions and were thus subject to the Interest Rate Restriction Act. In addition, the court held that the transactions in question were similar in nature to the discounting of promissory notes, which is a category of business that clearly requires registration under the Money Lending Business Act; however, the court did not determine whether the defendant had violated this act.

### **Comment**

It has long been recognised among practitioners in Japan's asset securitisation field that a sales transaction which fails to satisfy the requirements of a true sale transfer may be recharacterised as a secured lending transaction once the seller in such a transaction goes bankrupt. However, beyond this true sale consideration, there has been only limited concern that a sale and purchase transaction of receivables might be viewed as a lending arrangement that would require registration under the

## Money Lending Business Act.

In this regard, the Osaka District Court did not specifically rule in the above case that a purchase of receivables with full recourse (to the assets of the seller) should be categorised as a money lending business. In addition, as this case has been appealed, it remains to be seen whether the High Court will affirm or reverse the Osaka District Court's judgment. The Civil Code recognises sales of receivables – even those in which the seller fully assumes the risk of non-payment by the obligor after the receivables are transferred. That said, the Osaka District Court's judgment is a reminder of the risk that a transaction whose nature is more similar to lending (with full recourse to the borrower's assets) than to factoring (on a non-recourse basis) could be treated as a lending arrangement that requires registration under the Money Lending Business Act.

In light of this risk, any acquisition of receivables by an institution that does not possess the relevant lending licence in Japan should be properly structured to eliminate any concern regarding registration requirements under the Money Lending Business Act. In reaching its decision, the Osaka District Court focused particularly on the fact that the defendant did not bear the risk of non-payment by the obligors of debts which underlied the transferred receivables. Therefore, any acquisition of receivables heavily reliant on the seller's credit should be avoided if the purchaser is not registered to conduct a money lending business in Japan.

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