Asia Pacific Guide to Lending and Taking Security - Japan

If taking security

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# 1. Are there any classes of unsecured and unsubordinated creditor whose claims against a debtor would rank equally with or above those of the debtor’s secured creditors?

Yes, certain classes of claims (referred to in the answer to question 10 of the "When lending to borrowers" section) may rank equally with, or have priority over, the debtor's secured obligations.

# 2. May security given by a company rank in a specified order so as to secure liabilities owed to different creditors of the company in that order and, if that is not possible, is it viable for parties to enter into a contractual arrangement for the purposes of moderating this order?

Regardless of any agreement between secured creditors to the contrary, the general rule is that the priority of security interests held by different secured creditors over the same asset is determined by the date on which those security interests were perfected. Thus, the parties may arrange a subordination of the security interests by perfecting first (i), the senior lenders' security interests and then (ii) the subordinated lenders' security interests. However, some exceptions exist in relation to certain types of security, such as security assignments and security over dematerialized shares as set out below.

**Security assignments (*joto-tanpo*)**

As a security assignment is established by a transfer of the title to the asset, there is a strong argument that multiple security assignments in relation to that asset are theoretically impossible. Therefore, the question of ranking does not arise.

**Dematerialized shares**

Act No. 75 of 2001, as amended ("**Act Concerning Clearance of Bonds and Stocks, etc**.") provides that a pledge over shares can be created by an agreement between the parties and on the transfer of the shares to a pledge sub-account of the pledgee with a custodian (which can be, for example, a security firm or bank). Although not explicitly provided in the Act Concerning Clearance of Bonds and Stocks, etc., a pledge over book-entry stocks is interpreted as being perfected on registration and entry in the pledge section of the pledgee's sub-account. Under this system, syndicated lenders would be expected to hold a joint account in the name of all of the lenders (including subordinated lenders). Therefore, it is generally considered that ranking cannot be established by the timing of the registration only because a single registration applies to all the lenders. An intercreditor agreement is necessary to determine the ranking of the security interests among the senior/subordinated lenders.

# 3. Does this jurisdiction recognise the concept of floating security or similar equivalent (i.e., security over a changing pool of assets that the company giving the security is free to buy, sell and generally deal with)?

As the concept of floating security is not recognized in Japan in the same way as it is in the US or the UK, security interests in principle, must be granted on an asset-by-asset basis under Japanese law. However, it is possible to create a single security interest over multiple assets in certain cases as follows:

First, by way of a security assignment, by creating a single security interest over the following:

A changing pool of movable assets located within a specific physical area (typically, inventory in a warehouse)

Multiple present and future receivables

Second, in the form of a mortgage under the relevant special law (for example, in the case of a factory or plant, Act No. 54 of 1905 ("**Factory Mortgage Act**"), by creating a single security interest over certain types of groups of facilities such as plants or factories, including land, buildings, machinery, tools and other movable/immovable assets (other than inventory) connected to the facility ("**Foundation Mortgage**").

In addition, under Act No. 52 of 1905, as amended ("**Secured Bond Trust Act**"), all assets of the issuer of a bond may be given as security.  
  
On 20 January 2023, the Ministry of Justice published a draft interim report on the reform of collateral legislation. The draft interim report mentions, among other things, a new type of security interest to be created over the whole business of a company. The government's working group will continue the discussion on the more detailed concept and feasibility under the Japanese legal framework of such a whole-business security interest.

# 4. If so, are there any practical reasons why floating security is difficult to take, maintain or enforce?

There are some difficulties with creating a Foundation Mortgage (referred to in the answer to question 3 of this section). The setting up of a facility foundation in order to create a Foundation Mortgage tends to take more time than if security interests are created over the constituent assets one by one. This is for several reasons, including the requirement to give public notice of the Foundation Mortgage for one month and up to three months if movable assets are included in the facility foundation. In addition, a particular asset to which a third party has a right and a right over real estate (e.g., an ownership right or a lease right) that is not registered cannot be included in the group of assets that are subject to a Foundation Mortgage.

# 5. May security be granted to a trustee to be held on trust for the lenders from time to time, in such a way that a change of lenders does not require new security to be taken?

Yes, a security trust can be established where a licensed trustee holds the security interest on trust for the benefit of each lender under Article 3 of Act No. 108 of 2006, as amended ("**Trust Act**"). In that case, each secured party will obtain a trust beneficial interest (TBI) representing its interest in the assets of the security trust. If a lender assigns its loan to a third party, the assignor will also assign its related TBI to the assignee without disturbing the security interest, which remains held by the security trustee.  
  
Nevertheless, due to a lack of judicial precedent involving security trustees and the high costs involved in appointing a licensed trustee, security trust structures are uncommon in the market.

# 6. If not, are there any techniques that can be used to achieve substantially the same effect (e.g., parallel debt structures)?

Parallel debt would theoretically be possible but such structures have not been widely used in Japan to date. However, due to recent amendments, the amended Civil Code of Japan (Act No. 89 of 1896, as amended ("**Civil Code**")) now recognizes, among other things, that joint and several claims may be created by agreement among the parties. This change may promote the use of parallel debt structures in the future.

# 7. If an agent holds security for the lenders rather than a trustee, is it necessary to take new security on a change of lenders? If no, why not? If yes, are there ways to structure the transaction to avoid such a requirement?

The basic principle under Japanese law is that security must be granted to all lenders directly. Therefore, an agent cannot hold security on behalf or for the benefit of a group of lenders. If a secured lender assigns all or any of its rights under a secured loan to a new lender, the security interest will be automatically or contractually (depending on the nature of the security interest) assigned to the assignee, and therefore the assignment will need to be perfected.  
  
The possible alternatives to the use of a security agent are a security trust structure (see the answer to question 5 of this section) and a parallel debt structure (see the answer to question 6 of this section).

# 8. Under the laws of this jurisdiction, is there any class of asset over which it is difficult or impossible to grant effective and perfected security, or in relation to which any security granted will be of limited effect?

There are some classes of assets over which it is prohibited, or difficult, to create security as set out below.  
  
**Nontransferable assets**  
  
There are statutory restrictions on the creation of security over certain assets due to their nature or purpose. For example, the creation of security over rights to receive pensions is prohibited under Act No. 141 of 1959, as amended ("**National Pension Act**") and the creation of security over national health insurance is prohibited under Act No. 192 of 1958, as amended ("**National Health Insurance Act**").  
  
In relation to receivables, the debtor and the payee may agree to prohibit the creation of a pledge over, or a transfer of, the receivables. This is commonly achieved by the use of a non-assignment or non-transfer clause. This type of clause prohibits the granting of security over the receivables (or other benefits under the contract) without the consent of the debtor. Please note that, under the recently amended Civil Code, such prohibition of the assignment of receivables cannot be claimed against the assignee of such receivables unless the assignee has actual knowledge of, or was grossly negligent in not being aware of, such prohibition. However, as the lenders are usually aware of (and are expected to investigate) the existence of such non-assignment or non-transfer clauses in the ordinary course of their due diligence, it is still advisable, even under the amended Civil Code, to obtain consent from the debtor of the relevant receivables as to the creation of security interests.   
  
**Security over future claims**  
  
It is possible to create a pledge or a security assignment of future claims if any receivables that are subject to the pledge or assignment are appropriately specified. This practice is based on the rulings of the Supreme Court regarding the transfer of future claims (Supreme Court judgment of 29 January 1999), and the recently amended Civil Code expressly stipulates that it is possible to transfer and perfect future claims in the same manner as the current claims. However, please note that the court also implied that it may deny the validity of a security interest over future claims if it is contrary to public policy.  
  
**Administrative properties**  
  
The creation of security over government administrative properties (whether national or local) is prohibited under Act No. 73 of 1948, as amended, ("**National Property Act**") and Act No. 67 of 1947, as amended ("**Local Autonomy Act**").

# 9. Under the laws of this jurisdiction, are there any restrictions on offshore lenders taking security over any class of asset?

No.

# 10. Must a company receive a corporate benefit in return for giving a guarantee or security? In particular, are there restrictions on the grant of upstream and cross-stream guarantees and security? If yes, briefly what is the effect of these laws?

In Japan, there is no concept of "corporate benefit" as typically seen in some Western countries. However, if a company gives a guarantee or security, this may be considered a violation by the directors of the company of the duty of care or duty of loyalty that those directors owe to the company if it is not given for the company's benefit, as required under the Civil Code and Act No. 86 of 2005, as amended ("**Companies Act**").

# 11. What type of security interests does your jurisdiction recognise, e.g., pledge, charge, mortgage, hypothecation? In relation to each type of security interest, please state the formalities required to create and perfect that security.

Security interests are recognized under statutes or by court precedents.

The statutory security interests include mortgages (*teito-ken*), revolving mortgages (*ne-teito-ken*), pledges (*shichi-ken*) and statutory liens (*sakidori-tokken*) on immovable property.

Security interests recognized by court precedents are security interests by way of assignment (*joto-tanpo*) (security assignments), pre-agreed resale transactions (*sai-baibai-no-yoyaku*) and (although not, strictly speaking, a security interest) retention of title agreements (*shoyuuken-ryuuho*).

The methods for the creation and perfection of security interests vary depending on the type of security interest being granted and the type of asset being provided as security as set out below.

**Shares**

Under the Companies Act, an unlisted company may, in its articles of incorporation, choose whether or not to issue physical share certificates.

**Share certificates issued**

Where share certificates are issued, a pledge is established by:

An agreement between the parties; and

Delivery of the share certificates to the pledgee

The share pledge is perfected by the pledgee's continuous possession of the share certificates.

**Share certificates not issued**

Where certificates are not issued, a pledge is established by:

An agreement between the parties; and

Registration on the shareholders' register maintained by the issuing company (as perfection)

Lenders generally require the issue of share certificates when establishing a pledge over shares to ensure their control over any subsequent transactions in relation to the shares.

**Dematerialized shares of a listed company**

When transactions involve dematerialized shares of a listed company, transfers of those shares are conducted through a book-entry system maintained by the Japan Securities Depository Center, Inc. (JASDEC). A pledge over dematerialized shares is created by:

An agreement between the parties; and

The record of transfer of the shares to the pledge sub-account of the pledgee at the custodian (i.e., JASDEC system participants)

It is perfected by the electronic recording in the books of accounts.

**Receivables**

Security over receivables can be established by a pledge or a security assignment. In practice, a pledge is generally used for taking security over receivables (e.g., bank deposits, insurance proceeds and intercompany loans). However, a security assignment is commonly used for taking security over trade receivables.

There are three options for perfecting a pledge or a security assignment over receivables:

Issuing a date-certified notice to the underlying obligor (generally delivered by certified mail);

Obtaining the date-certified consent of the underlying obligor (date certification is done by a notary public); or

Registration of the pledge or assignment at the Legal Affairs Bureau

**Movable assets**

A security assignment of movable assets is established by an agreement between the parties and perfected either by delivery of the movable assets to the secured party or registration of the security assignment at the Legal Affairs Bureau. Physical delivery of the assets is not required if the parties agree that the security provider has delivered the underlying assets but retains them on behalf of the secured parties.

**Real estate**

A mortgage over real estate is established by an agreement between the parties and, to be perfected, must be registered at the Legal Affairs Bureau that is local to the relevant property. The application for registration is made by both parties to the mortgage, generally through a qualified judicial scrivener acting on behalf of both parties.

**Intellectual property**

Registration at the Patents Office is required to establish a pledge over trademarks and patents. A pledge over copyright is established by an agreement between the parties and, to be perfected, must be registered at the Agency for Cultural Affairs or the designated registration organization.

# 12. Are there any registration, translation or notarization requirements in relation to security, guarantees, subordination or intercreditor documents?

A registration tax is imposed depending on the nature of the secured assets. For example, the registration tax for real estate mortgages is 0.4% of the secured obligations (i.e., the principal amount of the loan). To avoid the registration tax, a mortgage may be registered on a provisional basis until a specified event (such as a default) occurs. The provisional registration must be converted to a full registration prior to any enforcement of the mortgage.  
  
Please also see the answer to question 8 of "When lending to borrowers."

# 13. Are there any stamp, documentary, registration, notarization or other taxes, duties or fees chargeable in respect of security, guarantees, subordination or intercreditor documents? If yes, what are the amounts and when are they payable?

Mortgage agreements or pledge agreements are generally not subject to stamp duty. However, a nominal stamp duty is payable when security is created over receivables/real estate by way of a security assignment. Guarantees and intercreditor agreements are subject to stamp duty. The amount of stamp duty payable is usually nominal (e.g., JPY 200), unlike a loan agreement, which is subject to a contract amount (to determine the amount of stamp duty payable in relation to a loan agreement as explained in theanswer to question 8 of the "When lending to borrowers" section).

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