Introduction

THE UNIVERSAL LANGUAGE OF CROSS-BORDER FINANCE

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On behalf of the Duke University Global Capital Markets Center, which is co-sponsoring this symposium, I am pleased to welcome readers to the symposium issue. The focus, of course, is on securitization, an increasingly important area of cross-border, or international, finance. Both cross-border finance and securitization can be daunting to the uninitiated. Cross-border finance involves multiple legal systems with strange terms and sometimes even stranger rules. Even if one could master the complexities of a foreign legal system, one's mastery would inevitably be short-lived, for laws keep changing. This Article will show that learning and keeping up with changes in foreign legal systems is unnecessary.[1] What is needed is a grasp of the fundamental legal principles of cross-border finance, in order to ask the right questions of local counsel and understand the response and its implications.[2] It is, effectively, like learning a new language,[3]

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1. I speak, of course, from the standpoint of a lawyer who does not regularly practice in foreign jurisdictions, and clearly do not mean to suggest that foreign lawyers should not keep up with their own jurisdictions' laws.

2. It is important that local counsel understands the implications of the question in order to think through any related legal principles.

3. Professor Carl Bjerre, one of the reviewers of this Article, indeed would carry my "language" analogy further, suggesting that a financier's concerns can be similar to those of a tourist. For example, a tourist might look in a phrase book to ask, "Where is the police station?" whereas a financier would ask local counsel, "How may I enforce a judgment?" And both would ask, "How may I convert my money?" E-mail from Carl Bjerre, Associate Professor, University of Oregon School of Law, to Steven L. Schwarcz (Mar. 5, 1998) (on file with the author).

but one that has remarkable similarities to our own legal language if one focuses on the fundamentals.[4]

This Article is intended to give the reader a grasp of the fundamental legal principles of cross-border finance from the perspective of securitization. Nonetheless, many of the concepts discussed are more broadly applicable to any cross-border financing transaction, such as secured or unsecured lending or project finance.

Securitization is a financing technique whereby a company transfers rights in receivables or other financial assets to a special purpose vehicle (SPV), which in turn issues securities to capital market investors and uses the proceeds of the issuance to pay for the financial assets.[5] The investors buy the securities based on their assessment of the value of the financial assets, often without concern for the company's financial condition.[6] Thus, companies that otherwise cannot obtain financing now can do so; and companies that can obtain financing now may be able to do so at lower cost.[7]

Securitization has an increasingly international focus, in part because companies that wish to raise funds from the capital markets may not be located in countries with established capital markets.[8] In

4. In the following discussion, my perspective shifts back and forth among the company, its special purpose vehicle, and investors in securities issued by the special purpose vehicle, because all these perspectives must be taken into account in structuring a securitization transaction.

5. The concept of securitization is explained in a number of books and articles. *See generally* TAMAR FRANKEL, SECURITIZATION: STRUCTURED FINANCING, FINANCIAL ASSET POOLS, AND ASSET-BACKED SECURITIES (1991 & Supp. 1994); SECURITIZATION OF FINANCIAL ASSETS (Jason H. P. Kravitt ed., 1991) [hereinafter KRAVITT]; STEVEN L. SCHWARCZ, STRUCTURED FINANCE: A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION (2d ed. 1993) [hereinafter STRUCTURED FINANCE]; Christopher W. Frost, *Asset Securitization and Corporate Risk Allocation*, 72 TUL. L. REV. 101 (1997); Claire A. Hill, *Securitization: A Low-Cost Sweetener for Lemons*, 74 WASH. U. L.Q. 1061 (1996); Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J. L. BUS. & FIN. 133 (1994) [hereinafter *Alchemy*]. For an historical perspective, see Joseph C. Shenker & Anthony J. Colletta, *Asset Securitization: Evolution, Current Issues and New Frontiers*, 69 TEX. L. REV. 1369 (1991).

6. *See generally Alchemy*, *supra* note 5, at 141.

7. *See id.* at 141-42, 146 (showing that securitization can be less expensive than alternative funding sources and, even if not less expensive, can provide valuable "off-balance sheet" funding). A securitization transaction can be less expensive, for example, than a bank loan because banks raise a significant amount of their funds by issuing securities in the capital markets. In order to lend these funds at a profit, banks must charge interest rates that reflect a mark-up over their cost. A company that uses securitization to obtain capital market funding without going through a bank-intermediary avoids paying this mark-up. Of course, whether the company will prefer that alternative depends on whether the cost-saving is greater than the transaction costs of structuring the securitization. *See id.* at 146.

8. The term "capital markets" means any market where debt and equity securities are traded. Capital markets include private sources of debt and equity as well as organized mar-

order to access capital market funding, those companies will have to structure deals that cross their national borders.

I. THRESHOLD ANALYSIS: JURISDICTIONAL QUESTIONS AND THE SOURCE OF THE FINANCING

The first step in any potential cross-border financing is to determine its jurisdictional framework, including the jurisdictions of the company seeking financing and of the source of that financing. A French company seeking a loan from a French bank located in Paris is not engaged in a cross-border financing; it is a French financing and French law applies. But if a French company wants financing from a U.S. bank, or from U.S. (or London or Singapore) capital markets, it is a cross-border financing—requiring examination of the laws of the jurisdictions whose borders have been crossed and the manner in which those laws work (or, more often, fail to work) together.[9]

If capital markets are intended to be the source of financing, one *also* must consider the local regulatory restrictions on the use of those markets. For example, U.S. capital markets are a significant source of securitization financing because they have a broad investor base and efficient pricing.[10] However, the issuance of securities to in-

kets and exchanges. *See* JOHN DOWNES & JORDAN GOODMAN, DICTIONARY OF FINANCE AND INVESTMENT TERMS 59 (3d ed. 1991); THE PORTABLE MBA DESK REFERENCE: AN ESSENTIAL BUSINESS COMPANION 86 (Paul A. Argenti ed., 1994) [hereinafter PORTABLE MBA]. Securities under U.S. law is a broad term, not limited to stock or bonds. *See* 15 U.S.C.A. § 77b(a)(1) (West 1997); *see also* JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 117-207 (2d ed. 1997). Historically, the world's capital markets were concentrated in major financial centers such as New York, London, Hong Kong and Tokyo, and the securities traded were limited primarily to stocks and bonds. In recent years, however, business and legal innovation has spawned an array of securities that enable companies and investors to shift risk more precisely between them, thereby more accurately and efficiently pricing the rate of the return that the securities must yield in order to attract investors. *See* AMA MANAGEMENT HANDBOOK 6-31 (John J. Hampton ed., 3d ed. 1994) [hereinafter AMA HANDBOOK]. For a detailed discussion, see generally 1 THE NEW PALGRAVE DICTIONARY OF MONEY & FINANCE 302 (Peter Newman et al. eds., 1992).

9. My theme of knowing how to ask the right questions of local counsel presumes, of course, that there is a manageable number of jurisdictions in which local counsel will be needed. In some cases, many different jurisdictions have potential connections to the transaction. Resolving those conflicts of laws, to try to reduce the number of local counsel, is the subject of a considerable literature which is beyond the scope of this Article. *See, e.g.*, EUGENE F. SCOLES & PETER HAY LIPSTEIN, CONFLICT OF LAWS (1992); JOHN G. KOLLIER, CONFLICT OF LAWS (1994); DICEY AND MORRIS ON THE CONFLICT OF LAWS (Lawrence Collins et al. eds., 1993); FRIEDRICH K. JUENGER, CHOICE OF LAW AND MULTISTATE JUSTICE (1993); LAWRENCE COLLINS, ESSAYS IN INTERNATIONAL LITIGATION AND THE CONFLICT OF LAWS (1994).

10. Whether capital markets are efficient has been the subject of some debate. This debate revolves around the so-called "efficient market hypothesis." For a brief description, see

vestors in these markets may require disclosure and regulation, particularly if the securities are issued without restrictions on trading (so-called "public" offerings).[11] In contrast, offshore or Euromarkets may be more flexible,[12] but may have a more limited investor base. Issuers of securities sometimes can avoid regulation entirely by combining markets—for example, using U.S. capital markets for a private placement of subordinated debt to support a public offering of senior debt securities conducted offshore.

II. STRUCTURING THE TRANSACTION

Often a financing transaction—particularly a securitization—can be structured as a loan or a sale.[13] If structured as a loan, its form is

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COX, *supra* note 8, at 31-43. For an extended discussion, see generally ROBERT A. HAUGEN, THE NEW FINANCE : THE CASE AGAINST EFFICIENT MARKETS (1995).

11. In the United States, a complex regulatory framework exists for issuing and dealing with securities. This framework is based on the Securities Act of 1933 (15 U.S.C.A. §§ 77a et seq. (West 1997 & Supp. 1998)), and the Securities Exchange Act of 1934 (15 U.S.C.A. §§ 78a et seq. (West 1997)). For other countries see, for example, Giovanni Nardulli and Antonio Segni, *EU Cross-Border Securities Offerings: An Overview*, 19 FORDHAM INT'L L.J. 887 (1996); Samuel Wolff, *Recent Developments in International Securities Regulations*, 23 DENV. J. INT'L L. & POL'Y 347 (1995); Barry A.K. Rider, *Global Trends in Securities Regulation: The Changing Legal Climate*, 13 DICK. J. INT'L L. 513 (1995); Manning G. Warren III, *The European Union's Investment Services Directive*, 15 U. PA. J. INT'L BUS. L. 181 (1994); Joel P. Trachtman, *Unilateralism, Bilateralism, Regionalism, Multilateralism, and Functionalism: A Comparison with Reference to Securities Regulation*, 4 TRANSNAT'L L. & CONTEMP. PROBS. 69 (1994).

12. The prefix "Euro" indicates a type of transaction which is conducted offshore and involves lenders or borrowers from countries other than that of the currency of denomination. The markets are primarily the Eurobond, Eurocredit and Eurodollar markets. Eurobonds are corporate bonds in U.S. dollars or other currencies, which are sold outside the country whose currency is used. *See* PALGRAVE DICTIONARY, *supra* note 8, at 783. They "have become an important source of debt capital for both large and small companies throughout the world. Normally, a Eurobond issue is syndicated by a consortium of international investment banks. This provides wide exposure to investors in different countries." PORTABLE MBA, *supra* note 8, at 174. Eurocredit is a loan offered simultaneously from several banks from more than one country. *See* PALGRAVE DICTIONARY, *supra* note 8, at 783. Eurodollars, a subset of Eurocurrency, means U.S. currency held in a deposit outside the United States, primarily Europe. Sometimes securities, debt as well as equity, will be denominated in Eurodollars, which will have the effect of principal, interest and dividends being paid out of U.S. dollars deposited outside the United States. Whether this is attractive or not is influenced by exchange rates, but U.S. companies tend to

> raise capital in European [or other overseas] markets when U.S. market rates are unfavorable. This action can be an especially attractive avenue for companies making an initial public offering that splits into two tranches—one to be traded on U.S. exchanges, and the other, a Eurotranche, to be traded on a European exchange.

PORTABLE MBA *supra* note 8, at 175.

13. For an article analyzing whether particular securitization transactions should be viewed as loans or sales, see Peter Pantaleo et al., *Rethinking the Role of Recourse in the Sale of Financial Assets*, 52 BUS. LAW. 159 (1996).

relatively simple. However, investors may prefer a sale structure. This is particularly the case where local law would protect the company's assets against creditor enforcement, as with the automatic stay under U.S. bankruptcy law.[14] When deciding how to structure the transaction, the essential question is the extent to which the investors providing the financing will be repaid in the event of the local law equivalent of a bankruptcy case.[15]

A related question is how the company must account for the transaction on its balance sheet. If the transaction is a loan, the company would account for it as debt. But if the transaction is accomplished through a sale, the company may be able to avoid booking a debt (so called "off-balance sheet financing").[16] The ultimate accounting treatment, however, would be subject to the accounting principles that prevail in the company's jurisdiction.[17]

III. COMMERCIAL FINANCE ISSUES[18]

We next examine how the SPV and its investors stand as against the company's creditors, and whether any part of the transaction is potentially preferential, fraudulent (whether intentionally or, under

14. *See* 11 U.S.C. § 362 (1994). A secured creditor could not foreclose on its collateral without court permission, which is rarely given. European countries increasingly have been adopting bankruptcy laws that include a stay of action by creditors against a bankrupt company in order to facilitate the company's rehabilitation. *See generally* Eberhard Schollmeyer, *The New European Convention on International Insolvency*, 13 BANKR. DEV. J. 421 (1997).

15. In many jurisdictions, a secured lender's remedies may be so strong that a sale structure provides only a marginal advantage. On the other hand, in some jurisdictions the commercial laws governing loans secured by financial assets may be so unsophisticated compared to the laws governing the sale of financial assets that a sale is a more prudent structure.

16. *See Alchemy*, *supra* note 5, at 142.

17. Accounting principles vary widely between different systems; in the United States, "Generally Accepted Accounting Principles" (GAAP) are used for reporting purposes. For other purposes, as in tax or corporate law, deviations from GAAP are used. How substantial the differences between jurisdictions can be is best illustrated by an example. When Daimler-Benz, the German automaker, wanted to have a listing on the New York Stock Exchange it did not want to file financial information according to U.S. GAAP. When it eventually did file, it showed a loss of DM 949 million instead of a profit of DM 168 million it had shown under German accounting rules. *See* David Waller, *Daimler-Benz Pierces Accounting Mystique*, FIN. TIMES, Sept. 23, 1993, at 24, *available in* WESTLAW, FTI database. *See also* Richard Waters, *Survey of Accessing the U.S. Capital Markets (2): The World According to U.S. GAAP*, FIN. TIMES, Feb. 1, 1996, at 34, *available in* WESTLAW, FTI database. An additional article, by Jason Kravitt, on international accounting standards for cross-border securitization transactions was not completed in time for this symposium issue and is expected to be published in a subsequent issue of the *Duke Journal of Comparative & International Law*.

18. For a more complete discussion of commercial finance issues arising in securitization, see generally STRUCTURED FINANCE, *supra* note 5.

local law, constructively), or in some other way problematic. These questions typically are addressed by laws that seek to allocate priority to collateral or to ensure equality of distribution, or to preserve the integrity, of a debtor's estate.

A. Perfection

The term "perfection" often is used to refer to protection of a transferee's interest in transferred assets from creditors of the transferor.[19] For assets that are physically located in a particular jurisdiction, the law of that jurisdiction, or sometimes of the transferor's jurisdiction, usually governs perfection. In a securitization transaction, perfection means protecting the SPV's interest in the transferred financial assets from claims of the company's creditors.[20] Because financial assets are intangible, and therefore not physically located in any particular jurisdiction, the law of the company's jurisdiction intuitively would be expected to, and usually does, govern perfection.[21]

Some jurisdictions have a filing or other public notice system for perfection.[22] Other legal systems may require notification of obligors, which may be unacceptable and expensive.[23] Often, the local perfection procedures may be unclear or impractical, in which case inves-

19. Or from the transferor's bankruptcy representative. In some jurisdictions, the concept of perfection is not well recognized. Once an asset is transferred, the transferor is simply deemed no longer to have an interest in the asset.

20. *See* STRUCTURED FINANCE, *supra* note 5, at 37-40.

21. Under the UNCITRAL proposal, the location of assignor would govern. *See* Spiro V. Bazinas, *An International Legal Regime for Receivables Financing: UNCITRAL's Contribution*, 8 DUKE J. COMP. & INT'L L. 315, 320 (1998). *Accord* U.C.C. § 9-103(3) (1995). This is not, however, a universal rule. Some jurisdictions may look, for example, to the "law of the receivable," meaning the law of the contract under which the receivable arose or the law of the jurisdiction where the obligor is located. 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.

22. The purpose of filing is "to place third parties on notice of the transfer" of the asset. *See* STRUCTURED FINANCE, *supra* note 5, at 37. In the U.S. this is usually done by filing a U.C.C.-1 financing statement.

> Any argument that the filing of U.C.C.-1 financing statements indicates the parties intention that the transaction constitutes a secured loan and not a sale can be obviated by stating on the financing statement that the intention is to create a sale and that the filing is being made because the U.C.C. requires it.

Id. UNCITRAL has proposed a registration system; on this issue see Bazinas, *supra* note 21.

23. Besides the obvious costs involved in having to notify all the obligors of, for example, trade receivables, it sometimes may also be culturally unacceptable to do so because notification might be seen as a signal that the company is in financial difficulties. "This is a problem practitioners often run into. . . . But it is a problem that is not documented in the literature." Petrina R. Dawson, *Rating Games with Contingent Transfer: A Structured Finance Illusion*, 8 DUKE J. COMP. & INT'L L. 381, 399 n.102 (1998).

tors are forced to rely on the company's representations, warranties, and covenants that the assets transferred to the SPV are, and will remain, unencumbered by third parties.

B. Priority

Priority refers to the ranking of multiple claims against a transferred asset. In a securitization context, it means that the SPV's and investors' claims against the transferred financial assets are superior to any third-party claims.[24] Priority is normally accomplished, in a jurisdiction that perfects by filing, by being the first to file against the assets.[25] If the company seeking financing is located in a jurisdiction that does not have a filing or other registration system to indicate priority, the investors again may have to rely on the company's representations, warranties, and covenants. This, of course, creates a much greater risk of fraud than where a public filing system is used.

If the transaction involves financial assets that will be created at a future date,[26] one also must ask if the local law permits the transfer of an asset not then in existence.[27] Bankruptcy or insolvency laws[28] also may restrict a company's ability to transfer its future assets.[29]

24. Priority refers generally to the "relative ranking of claims to the same property . . . . In bankruptcy, [it] refers to secured claims that by statute receive more favorable treatment than other, unsecured, claims." BLACK'S LAW DICTIONARY 1193-94 (6th ed. 1990) [hereinafter BLACK'S].

25. Sometimes referred to as "first-in-time, first-in-right," this generally gives priority to the first person to file against the asset. Priority is ascertained by searching the filing records to determine whether other parties have prior filings against the relevant collateral or assets. *See, e.g.*, U.C.C. § 9-312(5) (1995).

26. For example, certain cross-border financings are supported by payments to be made in the future under international telephone contracts. An example for such a transaction is the private placement by Teléfonos de México, S.A. (TelMex), the Mexican telephone company (information about this transaction on file with the author).

27. The UNCITRAL proposal allows for this. *See* Bazinas, *supra* note 21. *See also* Steven L. Schwarcz, *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 (1993) (examining U.S. law on selling future payments under a contract not yet in existence). Many civil laws provide that a pledge or assignment can only be made when an asset exists. This is based on the civil law view that a pledge is a real right "as opposed to a personal right; it gives the creditor a right to seize and sell assets and get a privilege on the proceeds of the sale." Michael H. Rubin & McGinchey Stafford Lang, *Recent Developments In Security Devices, With an Emphasis on Louisiana Law*, SB21 ALI-ABA 571, 588, *available in* WESTLAW, ALI-ABA database.

28. Such as 11 U.S.C. § 552 (1994). *See* Steven L. Schwarcz, *Protecting Rights, Preventing Windfalls: A Model for Harmonizing State and Federal Laws on Floating Liens*, 75 N.C. L. REV. 403, 434 (1997) (analyzing U.S. bankruptcy law restrictions on floating liens, and arguing those restrictions should not apply to securitization transactions).

29. In a collateral context, a lien on future arising assets is often referred to as a "floating

C. Commingling

Another risk is that cash proceeds of assets pledged or sold to an SPV may be mixed, or "commingled," with the company's own funds.[30] This risk to some extent reflects common sense: if the company is freely permitted to use collections, a court may find the company's control inconsistent with the SPV's claim that it has a perfected interest in the collections. Local law may ameliorate this risk somewhat.[31] Commingling also can be prevented by using lockboxes, or by segregating cash flows. Control over cash flows—such as requiring obligors to make payments into a trust account located in the U.S.—also may mitigate the perfection risk.[32] If these approaches are not available, one should ascertain whether proceeds are traceable, and ask local counsel whether traced proceeds are protected.[33]

D. Preferential and Fraudulent Transfers

The bankruptcy, insolvency, or related laws of some jurisdictions may permit or require a bankrupt company (or its representative[34]) to avoid transfers of assets, or obligations incurred, by the company prior to its bankruptcy. Some of these laws—referred to as preference laws because they avoid preferential transfers—are intended to ensure equality of distribution of the company's assets among all its creditors.[35] Less frequently, transfers made or obligations incurred by a troubled company for less than equivalent value may be deemed to be fraudulent[36] and therefore voidable.

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lien." *See* U.C.C. § 9-204 cmt. 2 (1995).

30. *See* STRUCTURED FINANCE, *supra* note 5, at 34, 40.

31. *See, e.g.*, U.C.C. § 9-306(4) (1995) (providing a formula that limits to some extent the degree to which a perfected security interest will be lost by commingling).

32. In many civil law countries, however, bailment, custody, and other trust concepts are not always recognized with respect to commingled cash, as civil law countries generally do not recognize trust concepts. *See generally* Donovan W. M. Waters, *The Institution of the Trust in Civil and Common Law*, 252 RECUEIL DES COURS 113 (1995); Justin P. Thorens, *The Common Law Trust and the Civil Law Lawyer*, *in* COMPARATIVE AND PRIVATE INTERNATIONAL LAW: ESSAYS IN HONOR OF JOHN HENRY MERRYMAN ON HIS 70TH BIRTHDAY 309-15 (David S. Clark ed., 1990).

33. Another potential concern is that the method of perfection may refer to the original collateral, but not the proceeds. If the anticipated form of the proceeds is known (e.g., cash), that concern can be alleviated by also describing the proceeds.

34. Under U.S. bankruptcy law, that representative is called the trustee in bankruptcy. *See* 11 U.S.C. § 704 (1994).

35. In the United States, for example, 11 U.S.C. § 547 (1994) limits preferential transfers made within 90 days (or, if the transferee is an "insider," made within one year) of the company's bankruptcy.

36. Whether or not the transfer in fact is fraudulent. The concept of "constructive fraud,"

In a securitization context, preference and fraudulent transfer laws are unlikely to apply because any transfers of financial assets from the company to an SPV tend to be structured as sales for arm's length consideration.

IV. CONTRACTUAL AND LEGAL RESTRICTIONS

The next issue is whether contractual or legal restrictions affect the financing. There are two ways that contractual restrictions can arise. First, there may be restrictions in the contract pursuant to which collateral or financial assets are originated. For example, a lease or license contract may prohibit the lessor's (or licensor's) assignment of rights to payment received thereunder. Under U.S. law, certain restrictions on the assignment of financial assets, such as accounts receivable, are unenforceable, but the laws of other jurisdictions will differ.[37]

Contractual restrictions also can arise through covenants contained in the company's financing documents.[38] Sometimes financings must be restructured to get around a restrictive covenant.[39] This takes creativity and an understanding of how the covenant is to be interpreted. For example, would a covenant restricting a 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, the governing law is not always obvious. For example, the covenant may be contained in a financing document stated to be governed by English law, but the covenant may prohibit liens on assets of a company located in Mexico. To determine whether English law or Mexican law governs the interpretation of whether the financing in question violates the covenant by creating a lien, counsel in both jurisdictions must be consulted. Sometimes even then the answer may be unclear.

One also must consider whether local law itself restricts the financing.

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for example, is codified at 11 U.S.C. § 548(a)(2) (1994).

37. *See* U.C.C. § 9-318(4) (1995). *See also* Bazinas, *supra* note 21.

38. These financing documents typically 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* STRUCTURED FINANCE, *supra* note 5, at 28. On the issue of negative pledge clauses, see generally Thomas C. Mitchell, *The Negative Pledge Clause and the Classification of Financing Devices: A Question of Perspective* (pts. 1 & 2), 60 AM. BANKR. L.J. 153, 263 (1986).

39. And sometimes the covenants are so restrictive that the financing simply cannot be accomplished.

V. ENFORCEMENT ISSUES

In an international context, it is not enough to have theoretical rights under the law. The critical question is whether one can enforce those rights,[40] recognizing that the legal system granting the rights may not be the same as the one in which enforcement occurs, and that foreigners may not be viewed favorably when enforcing rights against local citizens. Investors will want the company being financed to submit to their jurisdiction, or at least the jurisdiction of the SPV.[41] Of course, investors must determine whether those jurisdictions would enforce such an arrangement. Submission to jurisdiction could entail, for example, appointing an agent of the company in the investors' (or SPV's) jurisdiction to accept service of legal process, usually referred to as a "process agent."

If investors can obtain jurisdiction over the company in their own (or the SPV's) jurisdiction, it may not matter that the company has no significant assets outside of its home jurisdiction. Investors would simply sue where the company has submitted to jurisdiction, obtain a judgment, and take the judgment to the company's home jurisdiction to be enforced.[42] However, counsel in the home jurisdiction should be consulted in advance to verify whether such a judgment would be recognized and what, if any, defenses could be raised to its enforcement.

Another potential problem is that the company itself could be

40. A scene from a Broadway play about a "realpolitik" elementary school class illustrates this general point. In the math lesson, the teacher asked how Joe, Jim and Bob would split six bananas if Joe had two, Jim had four, and Bob joined them for lunch. The answer was that Bob was strongest and took all the bananas.

41. To be able to adjudicate a case, a court must have both subject matter and personal jurisdiction. *See* BLACK'S, *supra* note 24, at 854. Subject matter jurisdiction means a court can hear a particular kind of case. *See id*. at 854, 1425. Personal jurisdiction means the court has legal power over the parties to enforce a judgment. *See id*. at 854. While several legal grounds exist for personal jurisdiction, from the perspective of a potential plaintiff the "safest" way to ensure such jurisdiction is to obtain consent of the party before a cause of action has arisen.

42. 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 Judgment Act. *See generally* 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; *see also* Christopher P. Hall & David B. Gordon, *Enforcement of Foreign Judgments in the United States*, 10 AUT INT'L L. PRACTICUM 57 (1997), *available in* WESTLAW, JLR database. In other countries similar laws exist. *See, e.g.*, INTRODUCTION TO THE LAW AND LEGAL SYSTEM OF KOREA 1152 (Sang Hyun Song ed., 1983).

immune from suit under its local law, particularly if it has sovereign or quasi-sovereign ownership.[43] Requiring the company to waive sovereign immunity may be a solution to this problem. In the U.S., for example, such a waiver is enforceable under the U.S. Foreign Sovereign Immunities Act of 1976, as amended.[44] This, however, only means that U.S. courts will respect the waiver of sovereign immunity. One still must ask local counsel whether the waiver will be respected in the company's jurisdiction.

Other sovereign risks include currency exchange controls—the risk that the company's home jurisdiction may limit the export or private use of U.S. dollars or other relevant foreign currency.[45] This risk might be mitigated by issuing securities denominated in local currency (rather than U.S. dollars).[46] Risk mitigation can also be attained if the company has significant assets outside its home jurisdiction or offshore obligors on financial assets,[47] or by arranging local currency swaps for U.S. dollars (discussed below). One should also inquire whether the company's home jurisdiction has ever imposed,

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43. Sovereign immunity is traditionally a concept of public international law. Under this concept the sovereign, historically the monarch, today the state and its officials, cannot be sued unless they consent. While it was considered to be absolute in the beginning, over time certain recognized exemptions have developed. *See* MALCOM N. SHAW, INTERNATIONAL LAW 491-522 (4th ed. 1997). The most important exemption under the U.S. Foreign Sovereign Immunity Act is the "commercial activity exemption." *See* 28 U.S.C. § 1603(d) (1994). A similar example can be found in the United Kingdom in § 3(3) of its State Immunity Act of 1978. *See* SHAW, *supra*, at 505.

44. *See* 28 U.S.C. §§ 1602 et seq. (1994).

45. Currency control has occurred before in several places, for example Brazil, Nigeria, China, Romania, South Africa, Venezuela and, at least de facto, in Mexico. *See, e.g.*, Scott McMurray, *Soybean Futures Prices are Expected to Plunge on Reforms Unveiled by the President of Brazil*, WALL ST. J., Mar. 19, 1990, at C12, *available in* WESTLAW, WSJ database; Thomas Petzinger Jr. & Peter Truell, *U.K. Audit Points to Larger BCCI Role by Two Top U.S. Cable-TV Executives*, WALL ST. J., Jan. 17, 1992, at A4, *available in* WESTLAW, WSJ database; *Trade Conference in Beijing Attracts U.S. Businessmen*, WALL ST. J., June 21, 1988, *available in* WESTLAW, WSJ database; *Romania Revives Currency Curb*, WALL ST. J., Feb. 27, 1992, at A8, *available in* WESTLAW, WSJ database; Ken Wells, *U.S. Investment in South Africa Quickens*, WALL ST. J., Oct. 6, 1994, at A15, *available in* WESTLAW, WSJ database; *Observer: Caracas Chestnut*, FIN. TIMES, July 25, 1994, at 15, *available in* WESTLAW, FTI database; David Asman, *The Americas: Complex Models Won't Stop Mexico's Peso From Tumbling*, WALL ST. J., Feb. 17, 1995, at A11, *available in* WESTLAW, WSJ database. For a description of the international obligations that impact a country's ability to impose exchange controls, see generally Central and East European Law Initiative, *Currency Exchange Controls: A Concept Paper Prepared for the Government of Bulgaria*, 29 INT'L LAW. 257 (1995).

46. However, exchange controls could limit the export of the local currency. Furthermore, investors may not want to invest in securities denominated in a local currency.

47. That way, enforcement against those assets or obligors will not, de facto, be subject to the local laws of the company's country.

or is likely to impose, debt moratoria of the type that would restrict the company from paying its debts to foreigners.[48] Finally, inquiry should be made as to whether the SPV must be licensed in that jurisdiction to enforce its rights against the company.

VI. CURRENCY EXCHANGE, SWAPS AND HEDGING

Currency exchange issues loom large in cross-border finance. The problem is that the currency in which investors invest may be different than the currency received to repay them. For example, if investors buy U.S. dollar-denominated securities to enable an SPV to purchase a portfolio of Japanese yen-denominated receivables, the investors would be taking the added risk that, when the receivables pay, the dollar-to-yen exchange rate would yield insufficient dollars to repay them.[49] Investors generally prefer the exchange rate risk to be "hedged"[50] through "swaps" and other derivative products.

A "derivative" product means a contract that creates future rights and obligations regarding an asset that underlies a larger transaction.[51] 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 at a future date for a negotiated

48. Debt moratoria have happened before, for example in the Philippines, South Africa and Russia. *See* Julia Leung, *Filipinos Plan Again to Issue Overseas Bonds*, WALL ST. J., Oct. 30, 1992, at B4B, *available in* WESTLAW, WSJ database; Neil Behrmann, *South Africa Hopes to Reschedule Debt as Total Declines*, WALL ST. J., June 11, 1993, *available in* WESTLAW, WSJ database; Terence Roth & Tim Carrington, *Moscow Stops Paying Bank Debt Principal*, WALL ST. J., Dec. 5, 1991, at A3, *available in* WESTLAW, WSJ database. Most recently, Indonesia was considering such a moratorium, but eventually opted against it. *See* Darren McDermott, *Jakarta's Debt Plan Opens to Mixed Reviews*, WALL ST. J., Feb. 3, 1998, *available in* WESTLAW, WSJ database. Certain countries may have political risks. Political risk insurance sometimes may be available to cover specific risks, although it is very expensive. *See* Claire A. Hill, *How Investors React to Political Risk*, 8 DUKE J. COMP. & INT'L L. 283 (1998).

49. Of course, investors could convert the yen to dollars on the spot market. "A spot transaction involves the immediate purchase of, payment for, and delivery of a fixed amount of a currency. Such transactions are said to occur on the spot market." AMA HANDBOOK, *supra* note 8, at 6-43. But fluctuating exchange rates put investors at risk that a weakened yen would yield insufficient dollars.

50. "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." *See id.* at 6-32.

51. *See, e.g.*, Joseph L. Motes III, Note, *A Primer on the Trade and Regulation of Derivative Instruments*, 49 SMU L. REV. 579, 583-84 (1996). A great deal of derivative documentation is standardized worldwide through use of so-called "ISDA forms" developed by the International Swaps and Derivatives Association.

price.[52] A forward contract is a contractual obligation to buy (or, from the seller's standpoint, 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—a forward contract covering each date that settlement is to be made.[53]

Currency hedging is accomplished by entering into a swap with a third party (called a swap counterparty[54]) to exchange the relevant currencies at the future settlement dates. The parties contractually agree in advance to the exchange rate that will be deemed to apply on those settlement dates to ensure that the currency conversion will yield sufficient dollars to repay investors.[55]

Investors, of course, will want to be comfortable that the counterparty will be able to perform its swap obligations on each settlement date if the net value of the swap at that date runs against the counterparty.[56] If, therefore, there is a realistic risk that the counterparty may be unable to perform, the investors may attempt to minimize performance risk by requiring the counterparty to collateralize its future obligations or obtain a third-party guaranty, not unlike a lender requiring assurance of future performance from a borrower. The performance risk also can be minimized by requiring the counterparty to make daily or other periodic adjustment payments of the

52. *See* AMA HANDBOOK, *supra* note 8, at 6-32; Motes, *supra* note 51, at 589.

53. *See* Motes, *supra* note 51, 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) ("The underlying assets may or may not be exchanged and are referred to as notionals."). The asset could be foreign currencies in the case of currency swaps in cross-border finance transactions, or might 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.

54. Counterparties are often financial institutions, or their affiliates, that deal in derivative products (swap dealers).

55. Thus, if the investors expect to receive payment in Japanese yen and, based on the anticipated amount of yen, need an exchange rate of 126.29 yen per U.S. dollar to be fully repaid in dollars, a swap counterparty would be sought who is willing to exchange dollars for yen at that rate on the future settlement dates. If on a settlement date the exchange rate has changed to 130 yen per dollar, the investors would be protected because the swap counterparty has taken the currency exchange risk. But the swap party would profit on the exchange if the exchange rate has become 125 yen per dollar.

56. That is, if the exchange rate has changed to make the value of the currency that the counterparty has agreed to sell higher than the price it agreed to accept for the sale.

changing net value of the swap, thereby reducing the risk that the counterparty will be unable to pay the net amount due at a future date. This is referred to as "marking to market."[57]

The terms of the swap agreement also may be relevant. For example, any conditions precedent to effectiveness may need to be satisfied at the closing when the investors provide financing. Also, the SPV may be subject to taxes if it gains the advantage of the swap.[58]

VII. TAX[59]

There are three main tax issues in any securitization financing: whether a transfer of assets from the company to the SPV constitutes a sale or a loan; whether the SPV used to effectuate the financing is itself subject to tax; and how investors in the SPV's securities are taxed on their investment.[60]

A. Does the Transfer of Assets from the Company to the SPV Constitute a Sale or a Loan?

This question is governed, of course, by the tax law of the company's jurisdiction, and can depend on whether benefits and burdens of ownership of the assets have been transferred.[61] If the transfer of assets from the company to the SPV is a sale for tax purposes, the company may have to recognize tax loss or gain in its own jurisdiction. Alternatively, if the transfer is a loan for tax purposes, normally it is tax neutral from the company's standpoint; but then there may be withholding taxes on interest paid on the loan.[62]

57. For a description of the mark to market methodology, see THE HANDBOOK OF CURRENCY AND INTEREST RATE RISK MANAGEMENT 25-29 (Robert J. Schwartz & Clifford W. Smith Jr. eds., 1990). Forward contracts that include periodic marking to market are called "futures contracts." For the relation between mark to market and futures, see MARSHALL & KAPNER, *supra* note 53, at 19.

58. Investors may try to require payments to be made net of taxes. *See* discussion in Part VII, *infra*.

59. The author thanks Willys H. Schneider for helpful comments on this section. For additional discussion of tax issues, see generally Willys H. Schneider, *Selected United States Tax Issues in Cross-Border Securitizations*, 8 DUKE J. COMP. & INT'L L. 453 (1998).

60. *See generally* STRUCTURED FINANCE, *supra* note 5, at 45.

61. Characterization of a given transfer as a sale or a loan also will depend on the legal context. Transactions can be characterized differently for tax, bankruptcy, or accounting purposes.

62. 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 STRUCTURED FINANCE, *supra* note 5, at 46.

A cross-border withholding tax is a jurisdiction's attempt to tax a *non-resident*'s interest income to the extent such interest is paid by a resident. 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. Because 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.[63]

Bi-lateral tax treaties (between the company's and the SPV's jurisdictions), where they exist, can reduce or eliminate withholding taxes. For example, tax treaties exist between the United States and most major European countries, and also among European Union countries.

A company could indemnify the SPV for any withholding taxes and agree to pay additional (gross-up) amounts necessary to assure the net amount received by the SPV. A lender SPV typically would negotiate to make the foreign borrower (the company) directly obligated for indemnity and gross-up payments. In a securitization, however, the company cannot always make such an indemnity and still achieve a "true sale."[64] Sometimes the risk of a withholding tax is covered by over-collateralization;[65] but that may be insufficient if the withholding tax liability cannot be quantified and therefore matched by assets.[66]

B. Is the SPV Itself Subject to Tax?

Another significant tax concern is whether an SPV is subject to a separate tax on its income—the so-called "entity-level" tax. Such a

63. Even if the SPV gets a tax credit in its own jurisdiction to avoid double taxation, the tax laws of different jurisdictions do not always perfectly match and the tax on the SPV may "kill" the transaction. It would therefore lead effectively to double taxation similar to that of an entity level tax. *See infra* note 67 and accompanying text.

64. "True sale" is one of the key elements of asset securitization. It means that the transfer effectively transfers the ownership of the underlying asset to the SPV. The main focus is on whether this transfer effectively removes the assets from the originator under bankruptcy law. For a detailed description of the concept, see STRUCTURED FINANCE, *supra* note 5, at 28.

65. Over-collateralization refers to intentionally maintaining a large discount on the outstanding balance of the receivables to be purchased. This is done to account for anticipated defaults and delays in collection. *See id.* at 6.

66. Withholding taxes usually apply only to interest on loans. If the transfer is a sale, a withholding tax may still be payable on interest bearing receivables purchased if the applicable jurisdiction treats discount on a sale as the equivalent of interest for withholding tax purposes.

tax can greatly reduce cash flow available to pay the SPV's investors (unless the tax is offset by a deduction for interest paid by the SPV on its debt securities). Resolution of this matter is governed by the tax law of the SPV's jurisdiction and may also be affected by the jurisdiction in which the SPV is deemed to be engaged in business.

If, for example, the SPV is formed in the U.S. (to issue securities to investors in the U.S. capital markets), normal U.S. tax rules would govern taxation of the SPV. Therefore if the SPV is a grantor trust or (for tax purposes) a partnership, there would be no entity level tax; but if the SPV were a corporation, there could be an entity level tax.[67] It should be noted that recent "check-the-box" rules in the U.S. permit most entities that do not publicly issue equity securities to choose non-entity level taxation. Also, entities that qualify as a financial asset investment securitization trust (FASIT),[68] which is similar in certain ways to a REMIC,[69] are not subject to an entity level tax.[70] On the other hand, if the SPV is formed outside the U.S., foreign tax rules would govern its taxation.[71]

If a U.S. entity is deemed to be "doing business" directly or through agents in a foreign jurisdiction, or if a foreign entity is deemed to be "doing business" in another foreign jurisdiction or in the U.S., the tax rules of that other jurisdiction may also apply. For example, if a foreign company acting as servicer of collateral or financial assets has authority to modify the terms of receivables purchased by a U.S. SPV, the SPV may be found to be "doing business"

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67. Under U.S. tax law, corporations are seen as entities different from their shareholders. Their income is therefore subject to a corporate income tax, with an additional income tax for the shareholders for dividends paid. This is not true for a so-called S-corporation, which is not subject to this separate corporate income tax. On this point, see BORIS I. BITTKER & JAMES S. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 1.05 (6th ed. 1994).

68. For a brief description of FASIT, see William A. Wurch, *The FASITnating Facets of FASITs*, PROPERTY & PROBATE, Nov./Dec. 1997, at 21.

69. Real Estate Mortgage Investment Conduits (REMICs) are "organizations formed to hold a fixed pool of real estate mortgage" which issue multiple classes of interests therein. *See* BITTKER & EUSTICE, *supra* note 67, at ¶ 1.06(3).

70. REMICs are not treated as entities and are therefore not subject to the separate income tax under 26 U.S.C.A. §§ 860A to 860G (West 1986 & Supp. 1998). *See* BITTKER & EUSTICE, *supra* note 67, at ¶ 1.06(3). For a description of the tax aspects of FASITs, see Haroldene F. Wunder, *Tax Facets of FASITs*, 15 J. TAX'N INVESTMENTS 22 (1997).

71. In each case, if shareholders of the SPV are in jurisdictions different than the SPV's jurisdiction, it will be necessary to determine whether the SPV is subject to an "anti-avoidance" tax on income imputed to such shareholders under their jurisdictions. For a discussion of the use of anti-avoidance provisions, see generally Andrew H. Kingissepp, *Canadian Tax Court Holds General Anti-Avoidance Rule Applies to Deny Tax Treaty Benefits to U.S. Resident*, 8 J. INT'L TAX'N 413 (1997).

through the company (as its agent) in the foreign jurisdiction, subjecting the SPV to foreign tax. It is therefore important to consult local counsel in order to structure the transaction to avoid a finding of "doing business," such as by limiting the scope of the company's servicing authority.

If an income tax treaty applies, an entity should not be subject to tax in another jurisdiction (apart from possible withholding tax) if it has no "permanent establishment" (generally no office or other place of business and no agents with authority to bind it) in the foreign jurisdiction.[72]

C. How Are the Investors Taxed on Their Investment?

This is normally governed by the tax law of each investor's jurisdiction, although the tax characterization of securities issued to investors in the SPV's jurisdiction (if different) may be relevant. Investors may also be subject to withholding taxes on cross-border interest payments.

D. Other Tax Issues

Swaps and hedges may be subject to taxation. For example, gain or loss may have to be recognized based on fluctuations in the relative value of U.S. dollars and the currency of the assets. There also may be tax issues where transfers are among related entities, such as multiple SPVs in different jurisdictions. The bottom line is therefore to coordinate with each jurisdiction's tax counsel, and try to obtain appropriate tax indemnities and gross-up provisions.

VIII. RATING AGENCY CONSIDERATIONS

It is increasingly common in cross-border financial transactions, and especially in securitizations, for investors to rely to a large extent on rating agencies for comfort as to the structure of the transaction and for informational diligence on the underlying collateral or other assets.[73] Rating agencies are private companies[74] whose business is

72. Stamp taxes, transfer taxes and value-added taxes on the purchase price of assets or on servicing fees also may be charged, and local counsel should be consulted regarding those taxes.

73. For a discussion of rating agencies, see *Alchemy*, *supra* note 5, at 136-44. *See also* Dawson, *supra* note 23. Investors, of course, should independently investigate the risk of their investments and not rely solely on ratings. *See infra* note 76.

74. Rating agencies are neither governmental agencies nor are they presently regulated in the United States. The only minimal form of governmental control is in the context of desig-

assessing the risks associated with the full and timely payment of debt securities.[75] The significance of the rating depends entirely on the reputation among investors of the particular rating agency. For rating debt securities issued in securitization transactions, the most respected and trusted agencies are Standard & Poor's Ratings Group, Moody's Investors Service, Inc., Fitch Investors Service, Inc., and Duff & Phelps, Inc., all founded in the U.S. but now having offices and providing ratings to investors worldwide.[76]

Long- and short-term debt have separate rating scales, generally reflecting the different risks associated with long- and short-term investing. The highest rating on long-term debt securities is typically AAA, with ratings descending to AA, then to A, and then to BBB and below.[77] The highest rating on short-term debt securities—such as commercial paper[78]—is typically A-1,[79] with ratings descending to A-2, A-3 and below. The higher the rating, the lower the rating

nating a rating agency a "nationally recognized statistical rating organization" (NRSRO). For a description of the informal process of designation, see Amy K. Rhodes, *The Role of the SEC in the Regulation of the Rating Agencies: Well-Placed Reliance or Free-Market Interference?*, 20 SETON HALL LEGIS. J. 293, 323 (1996). If a rating agency is designated as an NRSRO, its ratings can be relied upon by government agencies like the SEC in certain federal regulatory schemes. For example, Rule 3a-7 of the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-64 (West 1997 & Supp. 1998), exempts certain structured financings from registering and complying with that Act if, among other requirements, the securities are rated at least "investment grade" by at least one NRSRO. While there has been some debate whether more regulation is necessary, and the SEC itself has issued a request for comments on the use of the NRSRO designation in the context of Rule 3a-7, *see* Concept Release on Nationally Recognized Statistical Rating Organizations, SEC Release Nos. 33-7085; 34-34616, 59 Fed. Reg. 46,314 (Sept. 7, 1994), many believe that market forces create enough checks on rating agencies. *See generally* Rhodes, *supra*; Francis A. Bottini, Jr., Comment, *An Examination of the Current Status of Rating Agencies and Proposals for Limited Oversight of Such Agencies*, 30 SAN DIEGO L. REV. 579 (1993).

75. What is rated is both the likelihood of payment *and* the timeliness of payment on the securities. *See* Salomon B. Samson & Gail I. Hessol, *Ultimate Recovery in Ratings: A Conceptual Framework*, S&P CREDITWEEK, Nov. 6, 1996, at 25. Equity securities are not rated because they have neither a specified maturity date nor a contractually-fixed principal amount.

76. Rating agencies make their rating determinations based solely on information provided by the issuer of securities. Hence, a rating agency, whatever its reputation, cannot provide a rating that is more reliable than that information. Ratings do not, for example, cover the risk of fraud.

77. Long-term ratings also sometimes have "+" and "-" designations associated with the ratings. *See* KRAVITT, *supra* note 5, at 7-63.

78. Commercial paper means short-term debt securities issued by a corporation. "Typically, only large, quality rated firms issue commercial paper. Issuers like commercial paper because of its maturity, its flexibility and the absence of hard collateral." PORTABLE MBA, *supra* note 8, at 99.

79. A-1 is the highest short-term rating for Standard & Poor's, P-1 for Moody's, F-1 for Fitch, and D-1 for Duff & Phelps. *See* KRAVITT, *supra* note 5, at 7-65.

agency has assessed the risk associated with the securities in question.[80] Ratings below BBB- are deemed non-investment grade,[81] and indicate that full and timely repayment on the securities may be speculative.

Because a high rating signals low risk to investors, an SPV that issues AAA rated securities can more easily attract investors in its securities than can an SPV that issues AA or BBB rated securities. Therefore the SPV with AAA rated securities can charge a lower interest rate on those securities, and still attract investors, than can the SPV with the lower rated securities.[82] The lower interest rate lowers the SPV's financing cost, which in turn lowers the financing cost of the company for which the SPV was created.[83]

The existence and almost universal acceptance of ratings make it much easier for investors in the capital markets to assess the safety of a given issuance of securities.[84] In a securitization context, this facilitates the ability of an SPV to issue securities, and of investors in those securities to resell them to other investors. However, the almost universal demand by investors for ratings makes rating agencies to a large extent gatekeepers of the types of securities that investors will buy. That can slow down experimentation with potentially innova-

80. A rating usually is assigned to a particular issuance of a company's securities, and not necessarily to the company itself, because a company could issue different securities having different risk characteristics. Hence, a company's senior debt securities almost always would be rated higher than the same company's subordinated debt securities. Recently, however, some rating agencies, such as Standard & Poor's, have been assigning company ratings that apply to any issuance of the company's senior unsecured debt securities.

81. The term investment grade "was originally used by various regulatory bodies to connote obligations eligible for investment by institutions such as banks, insurance companies and savings and loan associations. Over time, this term gained widespread acceptance throughout the investment community." STANDARD & POOR'S, CORPORATE RATINGS CRITERIA 9 (1998) [hereinafter RATINGS CRITERIA].

82. An investor therefore sometimes may prefer, if it finds the extra risk acceptable, to invest in a BBB rated security rather than a AAA rated security in order to benefit from the higher interest rate. The rating addresses only the safety, and not the economic desirability to the investor, of the investment.

83. Accordingly, companies always want their SPV's securities to have the highest rating possible, given the risks associated with the applicable securitization transaction. This sometimes creates a conflict for companies or SPVs located in countries that have political or financial instabilities, because the rating on the securities usually is limited by the rating of the country itself. This is sometimes referred to as sovereign ceiling. *See* RATINGS CRITERIA, *supra* note 81, at 51.

84. Indeed, rating agencies view their ratings as worldwide standards, and not as relative risk standards within countries. Thus, a BBB rating on securities is intended to convey the same level of risk irrespective of the jurisdiction in which the securities are issued. Interview with Petrina Dawson, Managing Director and Associate General Counsel, Standard & Poor's Ratings Group (Mar. 11, 1998).

tive securitization structures.[85]

IX. CONCLUSION

This Article has highlighted and explained the fundamental principles of cross-border finance and has shown that they allow for universal communication in any legal system. In the context of an actual transaction, my central point is simple: retain local counsel with top expertise, know how to ask the relevant questions, and be sure counsel fully understands both the questions and their underlying rationale.

85. Although an extended discussion of rating agencies is beyond the scope of this Article, rating agencies tend to focus on the following issues: how much weight to give to over-collateralization?; does it matter if a true sale (usually not, so long as if the company fails, collections of the receivables can be used without delay to pay the investors); comfort level with underlying receivables, including large obligor concentrations; comfort level with the company originating the receivables; currency risks (currency swap counterparty risk); comfort level with, and track record of, the "sponsor" of the SPV; commingling/cash controls; sovereign risk issues; legal opinions (local counsel are often asked to address the following issues in their legal opinions: legal, valid, binding; true sale/remedies in bankruptcy or insolvency; non-consolidation of company and SPV; choice of law respected; perfection/priority; obligations at least pari passu; no violation of law or contract; no sovereign immunity; no preference, etc.; duties and taxes; issues regarding nature of the receivables; e.g., future payment streams).