

## FOREWORD

PAMELA B. GANN\*

This symposium issue of the *Duke Journal of Comparative & International Law* is the inaugural publication of Duke University's new Global Capital Markets Center. Recognizing the need for intensive research, publication, and teaching about capital markets, Duke University's Law School and its Fuqua School of Business jointly created the Center.

Historically, the world's capital markets were concentrated in developed areas such as London and New York City while the securities traded were limited primarily to stocks and bonds. However, as contributors to this issue make clear, capital markets and the types and complexities of securities traded have expanded internationally and the study of capital markets has taken on a global urgency.

Companies around the world often find that it is cheaper to raise funds from capital markets rather than from bank loans or other traditional funding sources.<sup>1</sup> As a result, companies increasingly structure transactions that cross their local borders in order to gain access to capital market funding. Regional equity markets have begun to emerge.<sup>2</sup> Business and legal innovations also have spawned an array of capital market securities that enable companies and investors to more precisely shift risk between them.<sup>3</sup> Thus, derivative products hedge currency, interest rate and certain other risks, and ingeniously designed securities allow financing that isolates specific risks against their related benefits. Typically, however, regulation lags behind market innovation.

---

\*Dean, Duke University School of Law.

1. See Thomas K. Hahn, *Commercial Paper*, 79 *ECON. Q.* NO. 2 (Federal Res. Bank of Richmond, Va.), Spring 1993; see also Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 *STAN. J.L. BUS. & FIN.* 133, 146-51 (1994); ROBERT E. LITAN, *THE REVOLUTION IN U.S. FINANCE* 12-17 (1991).

2. See, e.g., Joel P. Trachtman, *Unilateralism, Bilateralism, Regionalism, Multilateralism, and Functionalism: A Comparison with Reference to Securities Regulation*, 4 *TRANSNAT'L L. & CONTEMP. PROBS.* 69, 96 (1994).

3. See, e.g., KENNETH R. KAPNER & JOHN F. MARSHALL, *THE SWAPS HANDBOOK: SWAPS AND RELATED RISK MANAGEMENT INSTRUMENTS* 494-95 (1990); Alvin C. Warren, Jr., *Financial Contract Innovation and Income Tax Policy*, 107 *HARV. L. REV.* 460 (1993).

Raising capital at competitive costs is critical not only for established corporations but also for developing countries, which need capital to develop their economies and infrastructure. Furthermore, while new markets may experience exceptional initial success, sustained success requires a legal and regulatory infrastructure that provides suitable protection for investors.

These transformations are occurring in a rapidly changing technological environment that will increasingly impact the functioning of the financial sectors of both developed and developing countries. Recent advances in information technology, including improvement in the operation of and access to the internet, are dramatically impacting the functions and interactions of banks, brokerage houses, capital providers and investors.<sup>4</sup> The reliance on information technology raises a myriad of policy, regulatory and economic issues.<sup>5</sup>

The purpose of the Global Capital Markets Center is to combine the resources of Duke University's business and law faculties, as well as other faculties such as economics, to develop the conceptual and theoretical frameworks that are necessary to understand global capital markets and to extend and adapt existing models to current issues that remain unexplored. The Center will also work to determine how law and regulation are impeding or promoting progress toward capital market development generally, particularly in an environment increasingly dependent on advances in information technology.

One of the dominant means of capital formation in the United States and increasingly throughout the world is through asset securitization and structured finance. Each year, financial institutions structure trillions of dollars of capital market transactions through these mechanisms.<sup>6</sup> The expertise needed to structure these transactions is interdisciplinary and includes cross-border commercial finance, bankruptcy, tax, accounting, the regulatory environment, and derivatives and hedging. The purpose of this symposium on "International Issues in Cross-Border Securitization and Structured Finance" is to explore this important field on an international and

---

4. See, e.g., John C. Coffee, Jr., *Brave New World?: The Impact(s) of the Internet on Modern Securities Regulation*, 52 *BUS. LAW.* 1195, 1200-01 (1997); Steven M.H. Wallman, *Regulation for a New World: An SEC Commissioner Talks About Capital Formation in the Age of the Internet*, *BUS. LAW TODAY*, Nov./Dec. 1996, at 8.

5. See, e.g., Steven M.H. Wallman, *supra* note 4, at 8.

6. See John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 *YALE L.J.* 165, 172 (1997); Claire A. Hill, *Securitization: A Low-Cost Sweetener for Lemons*, 74 *WASH. U. L.Q.* 1061, 1062 (1996).

comparative basis. The symposium includes scholars and practitioners from both the private and public sectors who are leading authorities in this field.

The first article is by Professor Steven Schwarcz, Duke faculty Director of the Global Capital Markets Center and one of the world's leading authorities in the field of structured finance and asset securitization. This article provides an introduction to the basic principles of cross-border finance. Particular emphasis is placed on commercial finance, currency exchange, rating agency, and tax issues. The author contends that, once grasped, the fundamental legal principles underlying cross-border finance amount to a kind of universal language that can be utilized in any legal system. Professor Tamar Frankel, a faculty member at Boston University Law School and author of a two-volume treatise on securitization, views the development of the law of securitization as a modern *lex mercatoria*. Two puzzles are addressed: why actors in the securitization process develop innovative transactional models only to give away their intellectual work product in an effort to establish industry standards, and how cross-border securitization arose without a uniform governing law. She contends that the rules of securitization develop on a decentralized market level and that the resulting norms are absorbed into a body of international law in an interactive process. Consequently, cross-border securitization is a useful subject for examining legal change in countries that do not possess developed financial and legal infrastructures.

Professor Claire A. Hill from George Mason University School of Law, the author of scholarly articles on securitization as well as political risk, examines the important topic of political risk in capital markets. She defines political risk as those risks that are not present in a nation with a more stable business and economic climate. Appraisal of political risk is unique because of the difficulty in assigning accurate estimates, and the underlying risk paradigm of portfolio valuation is insufficient to capture the dynamic dimension of political risk. She argues that another paradigm incorporating the Knightian concept of uncertainty is more effective. She also examines the response of investors to crises with significant levels of political risk, such as the Latin American debt crisis in the 1980s. She concludes her article by assessing the impact of investors' reactions through structural transactions, such as "future flows," on finance theory.

Spiro Bazinas, the Secretary of the UNCITRAL working group on International Contract practices, discusses the new UNCITRAL

draft Convention on Assignment in Receivables Financing. Mr. Bazinas coordinates the working group and drafting of this uniform law, a project that began in November 1995. His article begins by highlighting some of the most obvious obstacles inherent in an international assignment system. These obstacles arise, quite naturally, because nation states have chosen to treat assignments quite differently. These differences make the drafting of an international uniform law both difficult and necessary. He explains that the working group has chosen to draft a uniform law that is as appealing to as many states as possible in order to encourage widespread adoption. The article contains helpful and interesting insights into the drafting process and provides thorough details on the evolution of the draft, pointing out along the way reasons why certain avenues were foreclosed or altogether rejected.

Professor Hideki Kanda, of the University of Tokyo law faculty, provides a comparative analysis of securitization in Japan. He initially describes existing Japanese securitized products, including commercial paper, mortgage deeds, and bank loans and leases. He examines both current Japanese securitization laws and legislative initiatives prepared by the Ministry of Finance and the Ministry of Justice, which he expects to expand the Japanese securitization market. Japan is in the middle of a major domestic reform of financial regulation, including that of securitization, which could lead to a flourishing market for securitized products. It is likely that these recent regulatory developments are part of a long-term trend towards a demand- rather than a government-driven economy, which would contribute to the regaining of international competitiveness of Japanese capital markets. Professor Kanda also discusses the impact of Japan's cultural and political framework on securitization. This framework includes the interaction among government ministries, the lack of litigation in administrative and legislative processes, and the strong political power of the banking industry, all of which impact Japanese financial regulation.

Petrina Dawson, Managing Director and Associate General Counsel at Standard & Poor's, examines from the standpoint of rating agencies an increasingly common but potentially troublesome structure in securitization transactions originating outside the United States. The author argues that the structure, which depends on contingent triggers to transfer the assets, amounts to a structured finance illusion and thus does not warrant any enhancement in the rating

given by rating agencies. Thomas Albrecht of Sidley & Austin reviews various international regulatory issues, such as capital adequacy requirements and the Basle Accord, the relation between accounting and derecognition of assets for regulatory capital purposes, and licensing or other regulatory requirements that may bind the special purpose vehicle used in asset securitization. The objective of this article is to indicate and elaborate upon legal issues that so often arise in the securitization of corporate credits, especially as the use of securitization to fund corporate loan assets has increased dramatically in recent years. In the final article, Willys Schneider of Kaye, Scholer, Fierman, Hays & Handler analyzes tax issues that arise in cross-border structured finance. These issues, ranging from withholding taxes and “earnings stripping” to taxation of the special purpose vehicles used in the transactions, can drastically affect the efficiency and savings of the securitization.

In summary, this group of articles provides the reader with the background for understanding securitization and structured finance in a global context; evaluates the source of legal norms that apply to these transactions, including the evolution of international norms; discusses the UNCITRAL draft to bring uniformity to the international assignment of receivables; provides a comparative look at securitization in the Japanese legal and financial environment; and provides a detailed look at particular regulatory, tax, and structural issues that impact securitization and structure finance transactions.

This comprehensive treatment of cross-border securitization and structured finance is a worthy first symposium sponsored by the *Duke Journal of Comparative & International Law* and Duke University’s Global Capital Markets Center, and furthers one of the Center’s goals to determine how law and regulation are impeding or promoting progress toward capital market development.