Digital assets and Enterprise Value Charge (EVC)

01

Intro: Digital Asset Challenge

- **Legal Ambiguity:** No unified framework for digital assets
  - Not recognized as property in Civil Code; legal characterization is dependent on case-by-case interpretation
- **Market Reality:** Digital assets actively traded with real economic value
  - Regulations exist (e.g., Payment Services Act for crypto-assets)

02

Enterprise Value Charge – partial approach to collateralization of digital assets

- **Comprehensive Coverage**: All enterprise assets including digital
  - Upon enforcement, court-appointed Trustees take control over all enterprise assets including digital.
  - Debtors are incentivized to provide full access to digital assets by thereat of criminal sanctions.
- **Captures entire economic value:** Captures economic value without legal definitions
  - Trustee monetization determines value.

03

Drivers for Enterprise Value Charge

◆ **International debate**

- **World Bank Group Doing Business (2019), where Japan was ranked 94th in 190 countries. (Getting Credit)**

◆ **Domestic challenge**

- **Develop (Future) Cash flow Lending Practices (w/o government guarantee):**
  - Shift from lending practices heavily dependent on real estate, balance sheet (past information) etc.
  - EVC is created to promote debt governance and (future) cash flow lending to smaller/younger/riskier firms.
- **Examples: Startups (**Venture debt), **M&A (LBO)**: Aging of SME managers, **Restructuring**: Post Covid-19 recovery

More on EVC

04 Theoretical Foundations

◆ **Benefits of Security Interest (not just "priority")**

- "Ex ante, by facilitating bonding and monitoring activity, **security**
  - ✓ **lowers the probability that the debtor will engage in wealth-reducing transactions**, and helps to reduce the probability of default" and
  - ✓ **permits creditors "to deter other creditors from engaging in a wasteful 'race to collect'** when the debtor is in financial difficulty."
- "Ex post, **by facilitating efficient enforcement, it can increase the overall 'size of the pie' for distribution**."

J. Armour, The Law and Economics Debate About Secured Lending: Lessons for European Lawmaking? European Company and Financial Law Review, Vol. 5(2008)

◆ **Secured by All Assets**

- **Promote debt governance** and **cash flow lending to smaller, younger, and riskier firms** (e.g., **MSME, M&A (LBO), Restructuring**)

05 Core Features of EVC

◆ **Legal architecture**

- **Coverage:** Entirety of company assets, including real estates, intangibles and future cash flows. (Article 7)
- **Perfection and Priority Order:** Debtor's commercial registry. Priority is by order of perfection. (Article 15&18)
- **Enforcement Proceeding:** Trustees, appointed by the court, have the exclusive right to manage the debtor's business and entire, and, to maintain enterprise value, pay for critical creditors with court permission. (Article 70-)

◆ **Functions to Risk Mitigation**

- **Debtor Misbehavior: Any acts outside the ordinary course of business** (e.g., disposal of its material assets) shall be invalid unless it is conducted with consents from all EVC holders**.** (Article 20)
- **Other Creditors Race to Collect:** EVC holders have power to **deter other creditors from engaging in a wasteful race to collect** when the debtor is in financial difficulty. (Article 19)

Before closing

Japan’s approach - Enterprise Value Charge (EVC)

06

Roles of Financial Services Agency

- **Legislative development**
  - Close collaboration between financial regulators and justice authorities in law reform.
- **Incorporation of Regulatory Elements**
  - EVC holders must obtain FSA licensing, subjecting them to ongoing supervision and quality control.
- **Credit Risk Management Framework**
  - Enables lenders to manage EVC-secured exposures in separate categories, with particular attention to future cash flow potential rather than solely historical asset values as in traditional risk management framework.

07

Implementation

- **Effective May 2025**
- **Significant challenges remain**
  - The shift from asset-based to cash flow-based lending requires not merely legal reform but fundamental changes in credit assessment and risk management practices.