

# Working Group on Distributions of Securitized Products

## Interim Report

July 24, 2008

Japan Securities Dealers Association

## 【Summary】

### (About the Interim Report)

This interim report represents a distillation of the discussions held by the Working Group on Distributions of Securitized Products (hereinafter referred to as the “WG”) from the first meeting (March 27 2008) to the seventh meeting (June 24 2008).

As indicated below, the WG was established for the purpose of formulating self-regulatory rules for the Japan Securities Dealers Association (JSDA). This interim report indicates the basic direction to be taken in the formulation of self-regulatory rules.

Based on the principles represented in this interim report, the WG will begin an examination of detailed aspects of actual transactions this fall, following which it plans to begin the process of creating self-regulatory rules.

### (Background to and purpose and basic policies of the WG)

To deal with the turmoil in financial markets set off by the subprime mortgage loan problem, the Financial Services Agency (FSA) has proposed revisions to portions of its comprehensive supervision guidelines for financial instrument businesses (hereinafter referred to as “the Supervision Guidelines”) to ensure traceability of securitized products. These proposed revisions are based on the debate and points made on the topic both in Japan and on international levels.

In response to these revisions in the Supervision Guidelines, the JSDA established the WG on March 4, 2008 to conduct a detailed investigation into establishing a procedure that will ensure the traceability of securitized products distributed by the JSDA’s member firms.

The purpose of the WG is to introduce measures to ensure the traceability of the underlying assets of securitized products and, thereby, create an environment where investors can confidently invest in securitized products as well as promote the nurturing of a securitization market that will contribute to the greater international competitiveness of Japan’s financial markets.

Taking into consideration the intent of the Supervision Guidelines, the WG will produce a “Unified Information Disclosure Format (provisional name)” (hereinafter referred to the “UIDF”). The format will aim to ensure the effectiveness of the self-regulatory rules formulated and provide concrete content to act as a base for establishing internal procedures. It will also supply a common platform for stylizing and standardizing information on underlying assets and related risk.

### (Definition and scope of securitized products covered by the WG)

The scope of the securitize products being considered by the WG is the scope of the securitized products covered by the Supervision Guidelines. Without putting any regulations on the distributors and with the exception of certain products for which there is clearly no problem in ensuring traceability, the scope covers almost all securitized products.

Of the products above, the scope of securitized products covered by the UIDF for the time being shall be commoditized securitized products, i.e., specifically RMBS, CMBS, ABS, and CLO products (all of which are debt types of primary securitized products).

### (Establishing a procedure for collecting and communicating details and risks of underlying assets)

As a rough indication of the direction to be taken regarding establishing a procedure for collecting and communicating details and risks of underlying assets as required under the Supervision Guidelines, the WG has set out the major points as listed in Section 4. – (4) – ① of this report “Perspectives on methods of communicating information.”

“Perspectives on methods of communicating information” provide no more than an indication of the direction to be taken. Given the diversity of securitized products, it is clear that further investigation is required in terms of the detailed aspects of actual transactions. Commencing in the fall, the WG will conduct a full investigation of the detail aspects of actual transactions leading up to the formulation of self-regulatory rules.

“Perspectives on methods of communicating information” begin by indicating basic concepts for overall common rules. Within that framework, the WG concludes that in the case that the UIDF is determined to be appropriate to use, then the information items to be collected and communicated are, in principle, the items of the UIDF.

#### (Unified Information Disclosure Format (provisional name))

The basic policy for creating the UIDF for RMBS, ABS, and CLO products is to use the model format of the Bank of Japan (BOJ)’s Workshop on Securitization and make the necessary adjustments. In addition, the WG will also use as a base the format of the Japan Office of the Commercial Mortgage Securities Association (CMSA), which has been produced incorporating the viewpoints of multiple stakeholders.

At the interim report stage, the WG created a Common Information Item List that follows the previously mentioned basic policy in listing up items with an emphasis on those items necessary for investors to do their own risk analysis. Starting in this fall, the Common Information Item List will be refined in practical terms by reflecting the opinions of a wide range of market related entities, including originators of securitized products. In addition, the list will be considered closely and carefully from the point of view of practical transactions before becoming the UIDF. At the stage where the WG’s work is being formulated into self-regulatory rules, the WG will consider whether or not the term “Unified Information Disclosure Format”, which suggests a written format, is appropriate to use.

#### (Establishing procedures for evaluating, calculating, and disclosing theoretical price)

The WG has decided to base its considerations of establishing procedures for evaluating, calculating, and disclosing theoretical price as required by the Supervision Guidelines, on the JSDA’s current guidelines for securities companies in providing market price information on financial instruments “Points for Securities companies to Consider in Providing Market Price Information” (August 2000).

#### (Roles of Rating Agencies and Information Vendors)

The WG held hearings with related parties regarding the roles of rating agencies and information vendors in the communication of securitization market information and held discussions. Although the discussions will not be directly reflected in the future formulation of self-regulatory rules, they contained many suggestions of how the information infrastructure of this securitization market would evolve along with the progress in information disclosure for securitized products. When considering the role that distributors should play in communicating information in the securitization market, it is extremely important to first explore this aspect of the market.

#### (Future Issues)

The interim report indicates a basic direction to take in formulating JSDA self-regulatory rules regarding securitized products. The main future issues for the WG are to introduce practicality into its work through investigation of the detailed aspects of actual transactions, to examine details that had not been fully considered and decided on at the interim report stage, and to convert its results into self-regulatory rules. Commencing in this fall, the WG will follow-up on these points, following the direction shown in this interim report and continuing to take into consideration the international debate on securitized products.

## 1. About the Interim Report

This interim report represents a distillation of the discussions held by the Working Group on Distributions of Securitized Products (hereinafter referred to as the “WG”) from the first meeting (March 27 2008) to the seventh meeting (June 24 2008).

The WG was established for the purpose of formulating self-regulatory rules for the Japan Securities Dealers Association (JSDA). Up to its seventh meeting, the WG discussed the basic thinking and policies on which the formulation of self-regulatory rules was to be premised. Therefore, the contents of this interim report (main report and attached Common Information Items List) indicate the basic direction to be taken in the formulation of self-regulatory rules and do not represent actual self-regulatory rules.

Starting in this fall, based on the direction indicated in this interim report, the WG will examine the detailed aspects of actual transactions, following which it plans to begin the process of creating self-regulatory rules.

Moreover, the WG had broader discussions on issues which will not be directly linked to the formulation of self-regulatory rules. These items are peripheral themes that cannot be embedded in self-regulatory rules, but are nevertheless strongly related to the securitization market and discussion of which would be considered valuable. Consequently, the interim report includes both 1) points related to the direction of formulation of self regulatory rules beginning in the fall and 2) points which cannot be included in self regulatory rules. For the convenience of readers, the former and latter points have been clearly separated in the interim report.

## 2. WG Members List (At July 24, 2008)

Chairperson	Atsuo Akai	Morgan Stanley Japan Securities Co., Ltd.	Managing Director
Deputy Chairpersons	Masayuki Asami	Daiwa Securities SMBC Co.Ltd.	General Manager Structured Finance Dept.
	Tomoyuki Okuzaki	Mitsubishi UFJ Securities Co., Ltd.	Executive Director Capital Markets Division
	Kenichi Takarada	Mizuho Securities Co.,Ltd.	Joint General Manager Investment Banking Business Promotion Dept.
Member Company representatives	Naoko Ehara	Goldman Sachs Japan Co., Ltd.	Vice President Securities Division Compliance
	Yasushi Masubuchi	Nikko Citigroup Limited	Vice President Compliance Department (1 <sup>st</sup> Meeting only)
	Yukio Osada	Nikko Citigroup Limited	Vice President Global Securitized Markets Fixed Income, Currencies & Commodities (From the 2 <sup>nd</sup> Meeting)
	Katsushi Kudo	OKASAN SECURITIES CO.,LTD	Senior Manager Foreign Securities Department
	Akifumi Sakurai	NOMURA SECURITIES CO.,LTD.	Executive Director Global Markets Planning Dept.
	Riro Sato	The Sumitomo Trust & Banking Co.,Ltd.	Senior Manager Structured Finance Department

Koichi Nakamura	Mitsubishi UFJ Trust and Banking Corporation Chief Manager Structured Finance Division I
Tetsuya Nagaoka	Mizuho Trust & Banking Co.,Ltd Deputy General Manager Structured Products Planning Department
Takafumi Funaba	SUMITOMO MITSUI BANKING CORPORATION Vice President Planning Group1/Business Promotion Group Planning Department Investment Banking Unit (Up to the 2 <sup>nd</sup> Meeting)
Shun Noguchi	Mizuho Bank, Ltd. Senior Manager Securities Division (From the 3 <sup>rd</sup> Meeting)
Ryuichi Horie	Deutsche Securities Inc. Managing Director Head of Credit Structuring & Marketing Global Markets
Hiromi Matsumoto	Tokai Tokyo Securities Co., Ltd. Senior Vice President Financial Products Business Development Department
Yuzo Yonemoto	Merrill Lynch Japan Securities Co.,Ltd. Director Global Structured Credit Products

(Other participants from member companies)

Shuichiro Takado	Morgan Stanley Japan Securities Co., Ltd. Executive Director
Takehiro Ando	Daiwa Securities SMBC Co.Ltd. Manager Structured Finance Dept. (1 <sup>st</sup> , 2 <sup>nd</sup> and 7 <sup>th</sup> meetings)
Fuminobu Imamura	Daiwa Securities SMBC Co.Ltd. New Products・ABS Group Deputy General Manager Fixed Income, Currency and Commodities (FICC) Research Dept. (3 <sup>rd</sup> ~ 5 <sup>th</sup> meetings)
Koji Matsushita	Daiwa Securities SMBC Co.Ltd. Deputy General Manager Investment Strategy Group Fixed Income Research Dept. (6 <sup>th</sup> Meeting only)
Shoko Tanabe	Mizuho Securities Co., Ltd. Deputy General Manager Process Control Office Investment Banking Business Promotion Dept.
Jun Imazu	Mitsubishi UFJ Securities Co., Ltd. Vice President Real Estate Investment Banking Division
Reina Ishida	Goldman Sachs Japan Co., Ltd. Vice President Securities Division Compliance (6 <sup>th</sup> ~ 7 <sup>th</sup> meetings)
Yusuke Ueda	Goldman Sachs Japan Co., Ltd. Vice President Credit Structuring & Marketing (2 <sup>nd</sup> ~ 4 <sup>th</sup> and 7 <sup>th</sup> meetings)
Kentaro Kuga	Goldman Sachs Japan Co., Ltd. Vice President Credit Structuring & Marketing (5 <sup>th</sup> Meeting only)
Hiroaki Shirai	Nikko Citigroup Limited Managing Director Head of Structured Credit Products Fixed Income, Currencies & Commodities (1 <sup>st</sup> Meeting only)
Yasushi Masubuchi	Nikko Citigroup Limited Vice President Compliance Department (2 <sup>nd</sup> ~ 5 <sup>th</sup> meetings)
Noriko Takano	Nikko Citigroup Limited Vice President Real Estate Finance Fixed Income, Currencies & Commodities (7 <sup>th</sup> Meeting only)
Yasuo Utsunomiya	OKASAN SECURITIES CO.,LTD General Manager Financial Products (From the 3 <sup>rd</sup> Meeting)
Kiichiro Matsumoto	NOMURA SECURITIES CO.,LTD. Deputy Managing Director Debt Solution Dept. (From the 5 <sup>th</sup> Meeting)
Shigeru Yagi	NOMURA SECURITIES CO.,LTD. Deputy Managing Director Asset Finance Department"
Hiroshi Osamura	The Sumitomo Trust & Banking Co., Ltd. Senior Manager Securities Business Division Structured Finance Department (1 <sup>st</sup> and 2 <sup>nd</sup> meetings)
Takashi Matsuyama	The Sumitomo Trust & Banking Co.,Ltd. Senior Manager Wholesale Business Plannning Department (All except the 1 <sup>st</sup> , 2 <sup>nd</sup> , and 4 <sup>th</sup> meetings)

Tadashi Ozakiya	The Sumitomo Trust & Banking Co.,Ltd. Senior Manager Real Estate Business Planning Department (7 <sup>th</sup> Meeting only)
Hiroshi Kawasaki	Mitsubishi UFJ Trust and Banking Corporation Senior Manager Real Estate Planning Division (3 <sup>rd</sup> ~ 5 <sup>th</sup> meetings)
Takeharu Baba	Mitsubishi UFJ Trust and Banking Corporation Senior Manager Real Estate Planning Division (6 <sup>th</sup> and 7 <sup>th</sup> meetings)
Shinichi Miyazaki	Mitsubishi UFJ Trust and Banking Corporation Senior Manager Real Estate Planning Division (2 <sup>nd</sup> Meeting only)
Emi Kosugi	Mizuho Trust & Banking Co.,Ltd. Head of Compliance & Risk Management Office Real Estate Planning Department (1 <sup>st</sup> ~ 3 <sup>rd</sup> and 5 <sup>th</sup> meetings)
Makoto Ito	SUMITOMO MITSUI BANKING CORPORATION Vice President Planning Department Investment Banking Unit(2 <sup>nd</sup> Meeting only)
Yukio Egawa	Deutsche Securities Inc. Managing Director Head of Securitization Research, Japan Global Securitization Research Global Markets (From the 2 <sup>nd</sup> Meeting)
Yoshishige Suzuki	Deutsche Securities Inc. Compliance Department Vice President(3 <sup>rd</sup> Meeting only)
Naohiro Nishida	Deutsche Securities Inc. Managing Director Head of Securitization Products Group Global Markets" (2 <sup>nd</sup> and 5 <sup>th</sup> ~ 7 <sup>th</sup> meetings)
Sanae Amagai	Merrill Lynch Japan Securities Co.,Ltd. Director Global Structured Finance and Investments Japan (4 <sup>th</sup> Meeting only)
Nobumasa Shimokawa	Merrill Lynch Japan Securities Co.,Ltd. Vice President Compliance Officer Office of General Counsel (1 <sup>st</sup> , 4 <sup>th</sup> , 5 <sup>th</sup> and 7 <sup>th</sup> meetings)
Chinatsu Hani	Merrill Lynch Japan Securities Co.,Ltd. Senior Director Senior Structured Product Analyst Research Department (2 <sup>nd</sup> , 3 <sup>rd</sup> and 6 <sup>th</sup> meetings)
Hironori Yanagi	Merrill Lynch Japan Securities Co., Ltd. Associate Global Principal Investments Real Estate Finance (2 <sup>nd</sup> and 3 <sup>rd</sup> meetings)

(Observers)

Shun Noguchi	Mizuho Bank, Ltd. Senior Manager Securities Division (Up to the 2 <sup>nd</sup> Meeting)
Mitsumasa Yamada	The Bank of Tokyo-Mitsubishi UFJ, Ltd. Senior Manager Securitization & Asset Finance Division (From the 4 <sup>th</sup> Meeting)
Yasushi Ikai	BNP PARIBAS Securities (Japan) Limited, Tokyo Branch Securitization Products Research Fixed Income
Tomohiro Miyasaka	CREDIT SUISSE SECURITIES (JAPAN) LIMITED Director Fixed Income Securitized Product Research
Toshiro Kojima	Japan Housing Finance Agency Director General Market Operations Department
Yoshihiko Watanabe	ORIX Asset Management & Loan Services Corporation General Manager Master Servicing Group
Takeshi Mugishima	Ministry of Land, Infrastructure, Transport and Tourism Director Land and Real Property Market Division Land and Water Bureau (Former Director of Land Information Division)
Tokio Morita	Financial Services Agency Director Securities Business Division Supervisory Bureau
Daikichi Momma	Ministry of Finance Deputy Director-General Minister's Secretariat (From the 2 <sup>nd</sup> Meeting)
Hirohide Koguchi	BANK OF JAPAN Director Head of Open Market Operations Section Financial Markets Department (Former Head of Market Infrastructure and Operations Planning)

(Participants from observer companies and associations)

Masaomi Sato	The Bank of Tokyo-Mitsubishi UFJ, Ltd. Manager Securitization & Asset Finance Division (6 <sup>th</sup> Meeting only)
Shigeo Yoshida	The Bank of Tokyo-Mitsubishi UFJ, Ltd. Manager Securitization & Asset Finance Division (7 <sup>th</sup> Meeting only)
Nobuko Katayama	Morgan Stanley Japan Securities Co., Ltd. Executive Director (2 <sup>nd</sup> Meeting only)
Yoshifumi Takafuji	Ministry of Land , Infrastructure , Transport and Tourism Policy Bureau Real Estate Industry Division Deputy Director (2 <sup>nd</sup> and 6 <sup>th</sup> ~7 <sup>th</sup> meetings)
Mitsuhiro Kawamoto	Assistant Executive Secretary to the Prime Minister (Former Deputy Director of the Securities Business Division, the Supervisory Bureau of the Financial Services Agency) (1 <sup>st</sup> ~4 <sup>th</sup> and 6 <sup>th</sup> meetings)
Yasuyuki Hiraoka	Financial Services Agency Planning and Coordination Bureau Planning Division Deputy Director (Former Deputy Director of the Securities Business Division, the Supervisory Bureau) (7 <sup>th</sup> Meeting only)
Toshitomo Imai	Financial Services Agency Planning and Coordination Bureau Planning Division Deputy Director (1 <sup>st</sup> ~4 <sup>th</sup> and 6 <sup>th</sup> ~ 7 <sup>th</sup> meetings)
Shunsuke Shirakawa	Ministry of Finance Director for Fiscal Investment and Loan Appropriation, Financial Bureau (Former Director for Fiscal Investment and Loan Program System) (From the 5 <sup>th</sup> Meeting)
Tetsuya Hiroshima	BANK OF JAPAN Director Deputy Head of Financial Market Analysis Financial Markets Department (From the 2 <sup>nd</sup> Meeting)

(Unified Information Disclosure Format Initiative Team)

Leader	Yukio Egawa	Deutsche Securities Inc. Managing Director Head of Securitization Research, Japan Global Securitization Research Global Markets
	Akira Ishiwata	Rating and Investment Information, Inc. Senior Analyst Deputy Managing Director Structured Finance Division
	Yusuke Ueda	Goldman Sachs Japan Co., Ltd. Vice President Credit Structuring & Marketing
	Hidetoshi Ohashi	Morgan Stanley Japan Securities Co., Ltd. Executive Director
	Keiji Okada	The Norinchukin Trust & Banking Co., Ltd. Senior Manager Head of Asset Finance Group Corporate and Financial Institution Business
	Ryousuke Kawahara	Mizuho Bank, Ltd. Manager Risk Management and Planning Team Credit and Alternative Investment Division
	Kei Kitayama	Moody's Japan K.K. Representative Director
	Atsunobu Takei	Japan Housing Finance Agency Manager MBS Market Operations Group Market Operations Department
	Koichi Nagao	Daiwa Securities SMBC Co.Ltd. Deputy General Manager Structured Finance Dept.
	Yuji Nakada	Standard & Poor's Associate Director Structured Finance Ratings Rating Service
Observers	Tomohiro Miyasaka	CREDIT SUISSE SECURITIES (JAPAN) LIMITED Director Fixed Income Securitized Product Research
	Takashi Ogawa	Mizuho Securities Co.,Ltd. Vice President Financial Institutions Solutions Dept. (1 <sup>st</sup> ~ 3 <sup>rd</sup> meetings)
	Takahiro Nemoto	Mizuho Securities Co.,Ltd. Vice President Real Estate Investment Banking Dept. (3 <sup>rd</sup> Meeting only)
	Takahisa Ishii	Mitsubishi UFJ Securities Co., Ltd. Vice President Capital Markets Division

### 3. Proceedings of Meetings

#### 1<sup>st</sup> Meeting (March 27, 2008)

- (1) Introduction of members
- (2) Outline of working group operations
- (3) Explanation of the Supervision Guidelines by the FSA
- (4) Current state of disclosure and issues in the securitization market
  - Mr. Mahaska of Credit Suisse Securities Japan (Securitization of monetary claims)
  - Mr. Ohashi of Morgan Stanley Japan Securities (Securitization of real estate)
- (5) Definition and scope of securitized products

#### 2<sup>nd</sup> Meeting (April 10, 2008)

- (1) Definition and scope of information on details of underlying assets and risks
  - Information disclosure format of BOJ's Workshop on Securitization (RMBS, ABS, and CLO products)
  - Information disclosure format of Japan Office of CMSA (CMSA Standards Subcommittee)
- (2) Definition and scope of securitized products (Continued from previous meeting)

#### 3<sup>rd</sup> Meeting (April 23, 2008)

- (1) Introduction of Financial Stability Forum Report (FSA)
- (2) Definition and scope of details of underlying assets and risks (Continued from previous meeting)
  - Information needed by investors to conduct risk/return analysis (Presentation by a securitization analyst)
  - Information items that rating agencies consider important in determining ratings (Presentation by a rating agencies)
  - Direction of the Unified Information Disclosure Format
- (3) Presentation by representative of the Japanese Institute of Certified Public Accountants (JICPA)
  - On Auditing the Evaluation of Securitized Products

#### 4<sup>th</sup> Meeting (May 15, 2008)

- (1) The role of information vendors in securitized product information disclosure
  - Presentations by representatives of Bloomberg and Quick
- (2) The role of rating agencies in the securitization market— focusing on current global information disclosure practice on securitized products
  - Presentation by representative of Moody's Japan
- (3) Third party inspections of securitized product information disclosure
  - Presentation by a Certified Public Accountant
- (4) Establishing procedures for collecting and communicating details and risks of underlying assets
  - Establishing procedures
  - Presentations by representatives of Morgan Stanley Japan Securities and Mizuho Securities
  - Counterparties in information communicating

#### 5<sup>th</sup> Meeting (May 27, 2008)

- (1) Establishing procedures for collecting and communicating details and risks of underlying assets (Continued from previous meeting)
- (2) Internal procedures on evaluating, calculating, and communicating theoretical prices

#### 6<sup>th</sup> Meeting (June 5, 2008)

- (1) Establishing procedures for collecting and communicating details and risks of underlying assets (Wrap up)
- (2) Internal procedures on evaluating, calculating, and communicating theoretical prices (Wrap up)
- (3) Unified Information Disclosure Format Working Draft
  - Presentation by the Unified Information Disclosure Format Initiative Team

#### 7<sup>th</sup> Meeting (June 24, 2008)

- (1) Finalizing interim report



## 4. Content of Discussions

### (1) Background to Establishment, Purpose, and Basic Policy of the WG

#### ① Background to Establishment of the WG

In response to the turmoil in financial markets arising from the subprime mortgages, the issue is being debated internationally by the Financial Stability Forum at the request of the G7 and by other organizations, such as the Subprime Task Force of the International Organization of Securities Commissions (IOSCO). Because the confusion caused by the subprime mortgage problem in financial markets in Japan has been comparatively limited, discussions have instead revolved around the medium- to long-term issue of establishing systems to prevent such an occurrence in Japan. Specifically, Financial Services Minister Yoshimi Watanabe's personal advisory group, the Financial Markets Strategy Team, pointed out in its first report (November 2007) that ensuring traceability was important and the same indication appeared in the plan unveiled by the FSA in December 2007 to strengthen the competitiveness of Japan's financial markets. Since securitized product trading is basically done between professionals, in some aspects legislative regulations do not suit the situation. However, given the current direction of domestic and international markets, it is desirable that distributors establish a procedure that delivers the necessary information to investors to enable them to make their own accurate risk/return analysis.

In view of these discussions going on domestically and overseas, the FSA proposed revisions to portions of its comprehensive supervision guidelines for financial instrument businesses (Hereinafter referred to as "the Supervision Guidelines") to ensure the traceability of securitized products. After opening up the proposed revisions to public comment during the period from February 7, 2008 to March 10, 2008, the revisions were enforced on April 2, 2008.

Based on the publicly announced revisions to portions of the FSA's Supervision Guidelines, the JSDA established the WG under the Bond and Financial Products Committee for the purpose of making a concrete investigation into (formulating self-regulatory rules for) establishing a procedure that will ensure the traceability of securitized products distributed by its member firms.

#### ② Purpose of the WG

The purpose of the WG is to pursue the following two goals by formulating self-regulatory rules that define the requirement of the Supervision Guidelines in concrete terms, thereby ensuring the traceability of the underlying assets of securitized products.

- (1) To deal with the issue of the lack of communication of the proper information on the content and risk of underlying assets making it difficult for investors to make their own accurate risk assessments of securitized products that is being discussed because of the current U.S. subprime mortgages problem. Doing so will forestall the occurrence of such a situation in Japan, establish an environment where investors can have confidence on about investing in securitized products, and promote a healthy primary (first-order) securitization market that will contribute to the nation's economy.
- (2) To stimulate demand for securitized products among both domestic and foreign investors that have a long-term demand and fundamental needs but have not invested in securitized products up to now by expanding and reinforcing the disclosure of information on the underlying assets and risk. In conjunction with (1) above (establishing a environment in which investors can feel confident), the WG will aim to promote the development of a securitization market that will contribute to the strengthening of the competitiveness of Japan's financial markets by improving the liquidity of Japan's securitization markets (especially the secondary trading market) and the degree of convenience as a fund raising method.

### ③ Basic Policy of the WG

Taking into consideration the intent of the Supervision Guidelines, the WG will produce a “Unified Information Disclosure Format (provisional name)” (hereinafter referred to the “UIDF”). The format will aim to ensure the effectiveness of the self-regulatory rules formulated and provide concrete content to act as a base for establishing internal procedures. It will also supply a common platform for stylizing and standardizing information on underlying assets and related risk.

The WG has determined a broad direction to be taken in the formulation of self-regulatory rules during its discussions in seven meetings held up to June 2008, which have been set out in the interim report, and will be publicly announced.

Following this step, the WG will reconvene this September, and will follow the direction laid down in the interim report in considering and deciding on details. The WG will aim to complete formulation of self-regulatory rules by the end of this year, which will then be put out for public comment. In February 2009, the WG will finalize its self-regulatory rules and prepare and publicize a final report.

Following their completion in February 2009, the self-regulatory rules will be enforced after a necessary period for preparation and familiarization.

### (2) Current state of and issues regarding disclosure in the securitized product market in Japan (Point which cannot be included in self regulatory rules)

The WG received an explanation of the current state of and issues in the securitization market in Japan from a securitization analyst, followed by a discussion.

#### ① Current state of and issues regarding disclosure in the monetary claims securitization market

Among all the securitized monetary claims on the market, only about 30 transactions publicly disclosed information on underlying assets. In addition, the 30 transactions did not have a unified disclosure format, using different items and definitions. As a result, it is not easy to compare the products.

While fair information is provided to primary investors in the form of monthly service reports, secondary market investors receive insufficient information. Among other problems, securities companies not involved in the arranging of the deal cannot price the product and cannot bring new investors into the market.

#### ② Current state of and issues regarding disclosure in the real estate securitization market

In Japan, there is insufficient information on macro-economic data on the overall market, such as occupancy of properties, real estate demand and supply, and the performance of non-recourse loans. This has proved to be a barrier for the development of the secondary market because it is difficult for investors to make decisions about purchasing or selling CMBS products on a secondary basis.

Even when assessing individual transactions, it is difficult to make comparisons because the definitions of necessary items, such as debt service coverage ratios (DSCRs) or net operating incomes (NOIs) are not unified.

Because there are various classes within the CMBS market, such as straight sale or refinanced products, the required items change slightly. However, as a minimum standard, a standard format is needed. In this regard, the Commercial Mortgage Securities Association (CMSA)’s approach will serve as a good reference.

In the U.S., information vendors supply data in a mostly fixed format.

According to a global information transparency index for real estate markets, Japan ranked a relatively low 23<sup>rd</sup> in 2006.

Disclosure items and definitions also are not standardized in the J-REIT market in Japan.

### (3) Scope of securitized products (Point related to the direction of self-regulatory rules)

The WG discussed the scope of securitized products that it should be considering, and listed up the following points.

#### ① Scope of the securitized products covered by the Supervision Guidelines (= scope of securitized products to be covered by WG discussions)

The Supervision Guidelines are considered to cover almost all securitized products.

However, among securitized products, the following (1) to (5) may be considered outside the Supervision Guidelines because even without regulating distributors, there is clearly no problem with their traceability.

##### (1) Products that (despite having a securitized products structure,) do not have the feature of transferring the entire credit risk of specified assets to other entities (cannot be said to be a collective investment scheme)

(Example 1) Trust beneficiary rights related to trusts of multiple diversified pools of monetary claims that being sold as monetary claims using a trust structure or as being used in a scheme to sell a business

(Example 2) Securities that can be considered to have the same purpose as sale of trust assets such as real estate trust beneficiary rights

##### (2) (Collective investment schemes that can be categorized as securitized products in practical terms,) Products for which the risk is clearly located

(Example 1) Securities where the underlying assets are sales receivables of specified companies (companies that have submitted securities reports), investment schemes that depend only on the credit risk of the specified company (company that has submitted securities reports) and for which information on said company is easy to obtain

(Example 2) ABCP 100% backed by credit support of bank

##### (3) (Collective investment schemes that can be categorized as securitized products in practical terms and for which the risk is not necessarily clearly located,) Products that are not sold to investors

(Example 1) Securities that are sold to the originator or conduit at the stage of creating the securitized product

##### (4) Structured bonds or notes

##### (5) Securities that are managed by fund managers who make investments and operations under researches and analyses and which carry the obligation of communicating to investors regarding investments and asset management performances

(Example 1) Investment trusts and investment companies

In addition to the aforementioned (1) to (5), the WG has concluded that the detailed scope of categories of securitized products for which there are clearly no problem with traceability will be discussed beginning this fall.

#### ② Scope of securitization products to be covered by the Unified Information Disclosure Format (provisional name)

Within the scope of securitized products to be covered by the Supervision Guidelines, the scope of the products to be covered by the UIDF for the time being shall be securitized products that have become commodities, specifically RMBS, CMBS, ABS, and CLO products (all of which are debt types of

primary securitized products). In addition, they all are required to provide disclosure information under the Financial Instruments and Exchange Law. Even in cases of “public offering” securitized products, the WG will include them as objectives of the UIDF based on the assumption that the statutory required disclosure items and those of the UIDF will be made compatible and steps taken to ensure no duplication between the statutory required disclosure items and those based on self-regulatory rules.

Starting this fall, the WG will work through other possibilities among securities to be covered by the UIDF other than the above mentioned four types, including other types of primary securitized products, equity type (preferred equity investments) securitized products, and secondary securitized products.

From a practical perspective, the UIDF will not be applied to securitized products that have overseas assets as their underlying assets. Nevertheless, because securitized products with overseas underlying assets are within the scope of the Supervision Guidelines, the WG will discuss ensuring traceability of such products starting in the fall.

There are securitized products that are not being addressed by the UIDF at this point or will not be addressed in the future because they are not suitable targets for the UIDF because of their highly individualistic features. However, it should be kept in mind that these products are only being excluded out of consideration for their highly individualistic features and not because they do not meet some standard set using required conditions for establishing a procedure.

#### (Reference 1) Debt and equity types of securitized products

The issuance types of securitized products (supposing the general scope of the term securitized products) can be roughly divided into “debt type” (bonds, trust beneficiary rights, CPs, loans) and “equity type” (preferred equity investments, investment in associations (*nini-kumiai*), and investment in anonymous associations (*tokumei-kumiai*)).\*

\*Note: These securitized products are categorized by their issuance structure, for example, among debt-type bonds, trust beneficiary rights, and loans, there are subordinated classes of bonds, trust beneficiary rights, and loans that have equity-type economic features and are sold to investors.

Of these issuance types, with respect to the equity types of securitized products, starting with preferred equity investments to *Tokutei Mokuteki Kaisha* (TMK), etc, in most cases of securitization of monetary claims, such preferred equity investments are financed by the originator to cover the initial costs of the TMK, etc. On the other hand, with respect to real estate securitization, in many cases preferred equity investments are invested in by the investors. Typically there is no credit rating from a rating agency in this case, and the preferred equity investments are not made on the basis of repayment of the investment on a face value basis. The information necessary to make the investment decision on acquiring the equity interest in the preferred equity investments varies according to the nature of the underlying assets and the capital structure of the securitized product. Therefore it is thought that these products are not immediately adaptable to the stylization and standardization of the UIDF. Looking at investments in associations (NKs) and investments in anonymous associations (TKs), of products recognized as securities equivalents, only trust beneficiary rights are covered by the Supervision Guidelines (Type 2 financial instrument businesses), and NKs and TKs are not covered. While TKs are based on contractual agreements between operators and investors, the information necessary to make an investment decision on acquiring the equity varies according to the nature of the underlying assets and the capital structure of the securitized product. Therefore it is thought that these products are not immediately adaptable to the stylization and standardization of the UIDF.

#### (Reference 2) Primary and secondary securitized products

Securitized products (supposing the general scope of the term securitized products) are either primary (first-order) or secondary (second-order) securitized products. Again, because the underlying assets of secondary securitized products have a wide range of products, the information necessary to

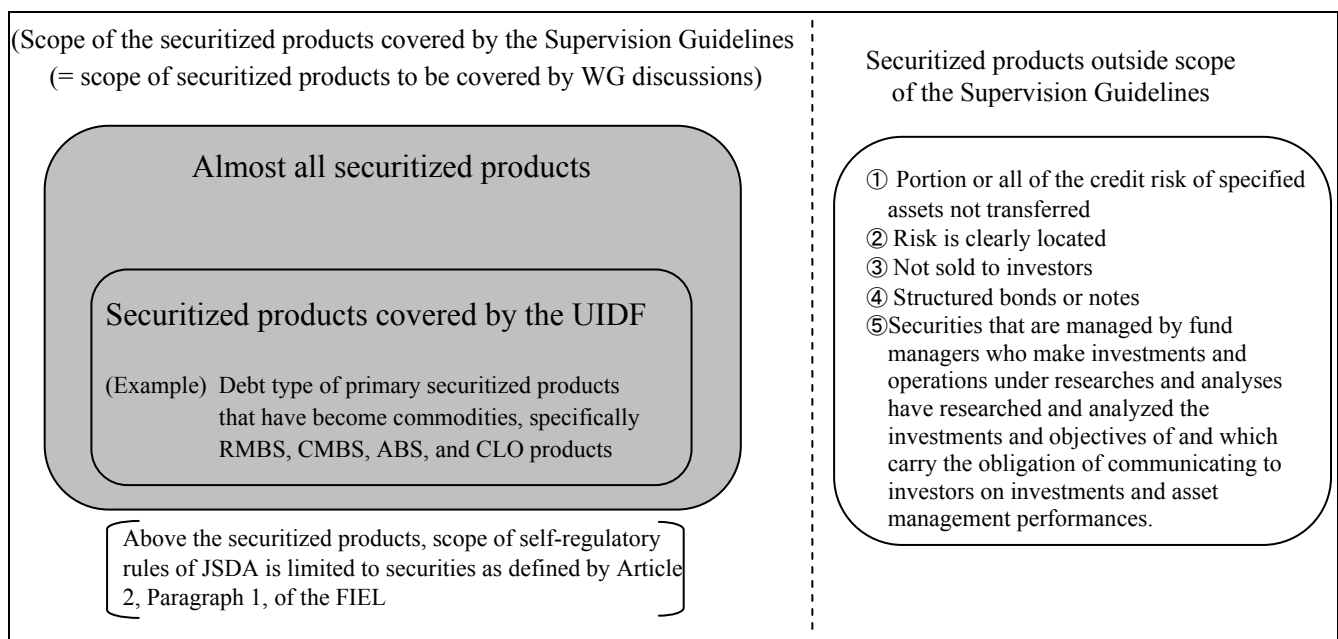
make an investment decision varies. Therefore it is thought that the secondary securitized products are not immediately adaptable to the stylization and standardization of the UIDF.

### ③ The scope of products covered by JSDA self-regulatory rules

The scope of securitized products to be covered by the JSDA self regulatory rules that the WG will be formulating starting in the fall is the same as the above mentioned ① (Scope of the securitized products covered by the Supervision Guidelines (= scope of securitized products to be covered by WG discussions). However, under the current articles of associations of the JSDA, the product classes covered are limited to marketable securities as defined by Article 2, Paragraph 1, of the FIEL (representative products are “corporate straight bonds” and “preferred equity investments”).

Considering the background of establishment of the WG and its core purpose of “ensuring the traceability of underlying assets,” we believe it is important to not be concerned with the product classes arising from securitization, but to set fair rules comprehensively. In addition, even though the WG as an organization under the JSDA cannot directly decide rules for products outside the authority of the JSDA, such as securities equivalent (deemed securities) stipulated by Article 2, Paragraph 2, of the FIEL and ABLs outside the scope of the FIEL, we believe that the WG should discuss these classes of products starting in this fall, and provide recommendations in the final report.

**Image of Scope of Targeted Securitized Products**

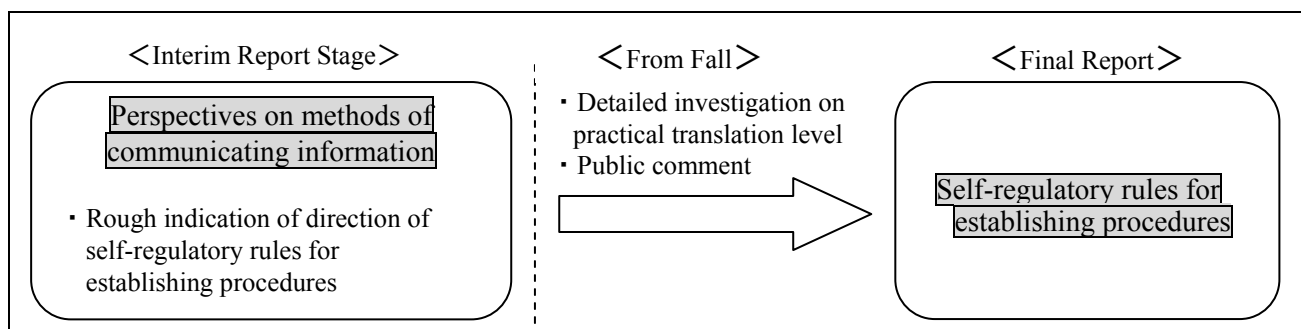


### (4) Establishing internal procedures to collect and communicate details and risks of underlying assets (Point related to the direction of self-regulatory rules)

#### ① Perspectives on methods of communicating information

The WG discussed matters related to establishing internal procedures to collect and report on details and risks of underlying assets, and compiled points indicating a rough direction to take as outlined in the following section on “Perspectives on methods of communicating information.” Perspectives on communicating procedures provide no more than an indication of the direction to be taken. Given the diversity of securitized products, it is clear that further investigation is required in terms of the detailed aspects of actual transactions (and obviously no self-regulation proposal at this time). Commencing this fall, the WG will conduct a full investigation of the detail aspects of actual transactions leading up to the formulation of self-regulatory rules.

## Image of Process of Self-Regulatory Rules for Establishing Procedures



### Perspectives on methods of communicating information

For distributors (excluding those with limited roles, such as merely intermediating the distribution, the same meaning hereinafter) establishing internal procedures will likely mean fulfilling both of the following Condition I and Condition II.

#### Condition I

##### (1) Basic principle

###### ① Prior to Distribution

- In collecting and communicating details and risks of underlying assets, distributors shall continue to fully follow the guidance of the Supervision Guidelines in considering the collection of information items necessary for the distributor to properly communicate the information. Having done that, after excluding the information items that cannot be collected; the distributor shall collect required information items.
  - ⇒ When asked by the investor regarding the reason for not being able to collect the information items deemed uncollectible, the distributor must be able to clearly explain why.
  - ⇒ If the reason for an information item not being collectible is that it was not disclosed by the originator, that explanation will be sufficient.
- To enable the proper report of information on the risk of underlying assets, the distributor will analyze risks judged necessary to communicate to investors or will collect analysis of said risks by others.
  - ⇒ Risk analysis will not be limited to quantitative analysis, but also include qualitative analysis.

###### ② Upon Distribution

- The distributor must consider whether to communicate the collected information items to investors. Having done that, the distributor must directly communicate to investors the information items judged necessary to be communicated. (Provided, however, that direct communication shall not be necessary if a third party or another method is used to communicate the information to the investors or the investors can access the information on their own.)
  - ⇒ The “another method” mentioned above shall include statutory disclosure or equivalent required disclosure.
- The distributor shall consider whether or not to communicate risks that are not reflected in the rating of a securitized product being sold to investors. Having done that, the distributor must directly communicate to investors risks judged necessary to be communicated. (Provided, however, that direct communication shall not be necessary if a third party or another method is used to communicate the risks to the investors or the investors can access information on the risks on their own.)
  - ⇒ The “another method” mentioned above shall include statutory disclosure or equivalent required disclosure.

### ③ Post Distribution

- If a distributor receives a request from an investor (Limited to investors that can be determined to be holding said securitized product, the same meaning hereinafter) for information to be used in an investment decision or as a price evaluation reference, the distributor will consider providing the information items collected on the details and risks of underlying assets for the investor that requested it in order that the investor may properly trade. Having done that, excluding the information items that cannot be communicated; the distributor will directly communicate to investors the information to the investor that requested it. (Provided, however, that direct communication shall not be necessary if a third party or another method is used to communicate the information to the investors or the investors can access the information on their own.)
  - ⇒ When asked by the investor regarding the reason for not being able to collect the information items deemed uncollectible, the distributor must be able to clearly explain why.
  - ⇒ If the reason for an information item not being collectible is that it was not disclosed by the originator, that explanation will be sufficient.
  - ⇒ The “another method” mentioned above shall include statutory disclosure or equivalent required disclosure.

### (2) When use of the UIDF is considered appropriate

When the securitized products to be distributed are those targeted by the UIDF (at this point, typical primary RMBS, CMBS, ABS, and CLO products) and the use of the UIDF is considered appropriate, the text of the above (1) ① to ③ shall be revised as follows.

#### ① Prior to Distribution

(Before revision)

“Distributors shall continue to fully follow the guidance of the Supervision Guidelines in considering the collection of information items necessary for the distributor to properly communicate the information”



(After revision)

“At the very least, the distributor will consider the collection of items in the UIDF.”

(Before revision)

“After excluding the information items that cannot be collected”



(After revision)

“after excluding the information items that cannot be collected and items judged not necessary to properly communicate information to investors”

#### ② Upon Distribution

(Before revision)

“The collected information items”



(After revision)

“The collected items of the UIDF”

#### ③ Post Distribution

(Before revision)

“The information items collected on the details and risks of underlying assets”



(After revision)

“At the very least items collected for the UIDF”

## Condition II

- (1) The distributor shall follow the internal procedures and rules regarding Condition I.
- (2) The distributor shall ensure the optimization of human distribution and organization

### ② Perspectives on human resources and organization

In the above “Perspectives on methods of communicating information”, there is the expression “uncollectible,” however, without a rational reason the distributor cannot decide information item is uncollectible.

It goes without saying that the distributor must not expand the interpretation of “uncollectible” in contradiction of the guidance provided by the Supervision Guidelines. In other words, (2) in Condition II requires that distributors must continue to make the proper decision regarding “uncollectible” information and to allocate human resources and establish the organization to enable the collection, communication, and analysis of information. For example, when handling securitized products, the distributor must allocate human resources with expertise regarding the collection, communication, and analysis of information, maintaining a balance between their trading volume and number of staff, and establish a division of labor and organization that takes into consideration the prevention of conflicts of interest required of distributors.

The WG has not gone into specifics concerning the issue of to what degree a distributor should allocate human resources and establish organization up to this point in its discussions because there is the issue of management decisions by distributors. However, in the fourth meeting presentations were made by two major securities companies containing the following cases and ways of thinking on this issue.

#### (Case, Perspective 1)

The main points that we follow in our business operations from the perspective of ensuring traceability are ensuring independence, clarifying job responsibility, and making sure checks and balances are in place. To that effect, our systems remove the possibility of intentional manipulation of information and avoid and manage conflicts of interest.

Keeping the origination and distribution of CMBS in mind, when securities companies use assets bought on proprietary accounts as the underlying assets in securitized products, they not only have to fulfill their responsibility as a market intermediate, but also as a so-called arranger responsibility by considering whether or not the transaction will damage their reputation with investors. First, the transactions undergo a strict credit analysis upon extending the loan on its own position. At this point, some proposed transactions are dropped because of credit problems in holding the loans as its proprietary positions, but the inspection does not just stop at this kind of risk management, it goes on to consider the product from the point of view of whether the execution of loans is appropriate considering the securitization process. In other words, it looks at the product from the point of view of risk management by the investor. In addition, at the creation and distribution stages, we provide proper disclosure and detailed explanations to investors regarding the details of the underlying assets and the securitized product structure. The important thing at this point is avoiding conflicts of interest. It is important to have a system that ensures the fairness of the process. At our company, the collection and close scrutiny of information is done by departments that have a certain degree of independence from the distribution promotion sections. At the disclosure stage as well, to prevent the information from being intentionally manipulated to the detriment of the investors’ interests, the legal and compliance departments are included in the process along with the distribution promotion sections to effect checks and balances.

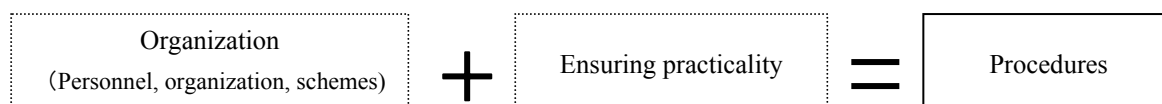
We recognize that the concept of arranger responsibility has— whether greater small—a certain degree of similarity with underwriter responsibility, which has mainly been discussed concerning equities. In actual fact, in the June 2006 report of the discussion points by the Round Table



Conference on the Financial Market Intermediation Function of Securities Companies, it was pointed out that “in this way, against the backdrop of the growing diversification and sophistication of the businesses of securities companies as market players, the business of securities companies...III) securities companies (group companies) create securitized products using underlying assets in which they made the principal investment and sell them to other investors with out proper explanation (risk transfer), and IV) in an environment where cases that pose (potential) conflict of interest, etc. problems are increasing, such as using SPCs and other vehicles for the purposes of manipulating accounting, proposing or trying securitization structures suspected of being for the purpose of tax evasion, and other cases.” Based on this, as a securities firm that creates and distributes securitized products, we have built and operate an internal control system capable of ensuring the protection of the public interest and investors.

Of course, there is no need to introduce the notion of underwriter responsibility exactly “as is” into the business of the origination and distribution of securitized products. However, considering the social responsibility of securities companies that distribute securitized products to a wide range of investors, we think the concept of underwriter responsibility, which has been well debated and tabulated in the equities markets, should be taken into account in the “Establishing procedures” given the similarities, great or small.

(Perspective 2)



In establishing procedures, in addition to the organizational aspect of establishing an inappropriate organization and the allocation of people, it is important to ensure their effectiveness.

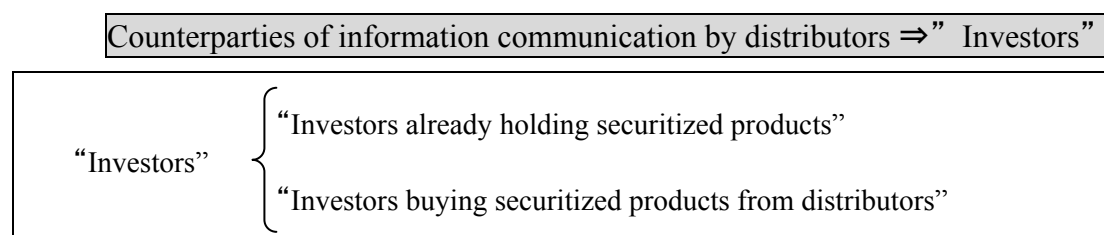
Procedures have to be revised even after they have been implemented to respond to changes in the market environment, in addition to responding to the risk that a procedure can lose substance in course of time.

Points (potential risks) to be considered when thinking about establishing procedures to create and distribute securitized products include 1) because expertise is required, it is not always easy to implement checks by third parties, 2) because the products often use complicated risk structures, it is not always easy to determine the risk, 3) because of the use of SPVs and other vehicles, the originator or arranger is not the direct counterparty, 4) a lot of different entities are involved, 5) even distribution of the product require expertise, and 6) even after distribution, it is essential to provide information disclosure and market prices. Even in the past, securities companies have been careful when it comes to establishing procedures to deal with these types of special features and risks of securitized products. Specifically, when creating these products they use checklists to visualize the details and processes of the proposed deal; set up systems organizationally, such as establishing departments specializing in inspection; increase the effectiveness of checks by allocating the job to people with experience creating securitized products; or keep a proper record of the inspection paper trail. In addition, detailed responses are also offered at the point of distribution, such as bringing along a securitized product specialist team to explain in detail the risks to investors, providing follow-up services after distribution by supplying information on the performance of the underlying assets, and developing products that incorporate the needs of investors.

To make further improvements in the procedures for creating and selling distributing products, this WG should not be satisfied with the current procedures. For example, we would like to propose the following. Improve the risk analysis inspection function in the procedure used to monitor product development. Improve the inspection function for the supply of information and market prices after distribution. In addition, raise the bar on the in-house inspection function at securities companies. We believe these are the steps that should be taken to improve transparency of securitized products and information disclosure.

### ③ Counterparties in information communicating

The WG discussed the counterparties of distributors in the collection and communications of details and risks of underlying assets, and determined the following points.



As shown above, the counterparties of information communication to be considered in the future formulation of self-regulatory rules are investors, and as such, there should be no obligation to make public disclosure of the information in the self-regulatory rules.

## (5) Unified information disclosure format (provisional name) (Products related to the direction of self-regulatory rules)

### ① Existing information disclosure formats

Before starting the process of determining a UIDF, the WG received explanations of existing information disclosure formats—the model format of the Bank of Japan (BOJ) Workshop on Securitization and the proposed Japan version of the investor reporting package (IRP) being worked out by the Japan office of the Commercial Mortgage Securities Association (CMSA)—from representatives of BOJ and CMSA-Japan and discussed these formats.

#### (1) The model format by the BOJ Workshop on Securitization

(Outline of the model format)

A representative of the BOJ gave the following explanation.

- With a view to contributing to the sound development of Japan's immature securitized products market, BOJ took account of issues raised by a wide range of market related entities from a market wide perspective. It set up the Workshop on Securitization for the period from November 2003 to April 2004 as a venue for discussion the direction the market needed to take to overcome these issues. To take a more detailed look at enhancing information disclosure as one of the key issues for the securitization market, a working group was formed to examine the matter. The model format is the result of the working group's findings.
- The model format was created for the purpose of sharing a common recognition of the necessary information items for price valuation, investment decision, and risk assessment. It was positioned as a working draft for making progress with communicating information to investors as a market practice, and was not made with the intention of including it in regulations.
- The main points taken into consideration in producing the model format were 1) covering a wide range of investor needs, 2) whether or not the information was useful to the investor on a cost-benefit basis, and 3) whether the disclosure level was so high as to create a disincentive for issuers. Furthermore, the model format was designed to be used with any public and private offerings as well as bonds, investment trusts, and ABLs. There was no discussion on who provided the information and with what method. While it would be desirable to have a unified definition of each disclosure item, the majority of people believed that it could not be done in practical terms. Therefore, from the point of view of maintaining comparability of items, when there is no unified definition, it is recommended that there be a written definition of the item.

#### (Current use of the model format)

Currently, there are only a very limited number of cases where the model format is being used. Reasons for this situation were indicated in the WG as follows.

- One of the reasons for this situation was the lack of incentive during the expansion process of the securitization market up to this point. With ongoing deregulation in the financial market, the desire for higher yields among investors prompted them to invest in securitized products even though information is not being disclosed in some manner like the model format.
- It is possible that the originators or arrangers are so busy creating deals that respond to the needs of these kinds of investors that they find it difficult to always allocate sufficient resources to disclosure.
- It is possible that a certain portion of investors received the necessary information individually disclosed by the originators or arrangers.
- The main reason is that there has been no economic incentive for originators to disclose information. Also, with almost no secondary market, there is little incentive for originators to provide information to investors other than their primary investors.
- Possibly, it included too many items at the time.

It was pointed out that although there are extremely limited cases where the model format has been used, much of the information included in the model format is provided in the offering circular or the prospectus. Therefore, no matter what the structure, in actual fact in most cases the information being provided is similar to the model format.

Most of the information currently being provided publicly by information vendors has fewer items than the model format, but can be used to produce a lot of information if it is analyzed. It was asked whether it was necessary to through the process of determining what information is truly necessary in practical terms, using the model format as the point of origin.

## (2) About CMSA-Japan “Investor Reporting Package”

#### (Outline of CMSA)

The CMSA was established in 1994 in the United States, and is the largest industry association in world for CMBS, with a membership of over 400 companies. CMSA-Japan was established in 2003, following the openings of offices in Europe and Canada. All offices work together under a common global perspective. Their members comprise banks, trust banks, securities companies, rating agencies, servicers, investment companies, and accounting and legal offices.

The CMSA produced its first versions of the IRP in 1997 in the U.S. and in 2005 in Europe, with the goal of standardizing CMBS information disclosure. The increased transparency provided by the IRP contributed substantially to the growth of both primary and secondary CMBS markets. CMSA has updated its IRP on an ongoing basis in line with changes in the market, and unveiled its latest revision, the 5<sup>th</sup> version, of the U.S. IRP in February 2008.

#### (Japan version of the IRP)

In Japan, the Standards Subcommittee of the Japan office of CMSA began its examination of the Japan version IRP at the end of March 2008. Four sub groups were formed by function (trustee, investor, servicer, lender and arranger), and the basic proposals of each sub group (desirable information, disclosable information) were brought to the overall subcommittee by the sub-group leaders for discussion and comparison.

In creating the Japan version of the IRP, CMSA-Japan’s Standards Subcommittee is keeping the following points in mind.

- The IRP is a minimum standard; it should not obstruct the expansion of information disclosure to reflect the special features of individual CMBS.
- The document should try to standardize disclosure not just for CMBS, but for the entire real estate debt market, including lenders using balance sheets and renters.
- The subcommittee organized information and determined standard disclosure items for the following categories.
  - ① CMBS level (trust beneficiary rights, bonds, etc.) information\*
  - ② Underlying asset level (loans, TMK bonds, etc.) information\*
    - \* There are cases where the information of the CMBS and Underlying asset levels are combined, such as single tier structured trust beneficiary rights or TMK bonds, etc., but for information categories, they have been separated.
  - ③ Underlying property level information
- Even through the IRP of other markets will be used as a reference, the IRP for Japan should reflect the special features of CMBS in Japan.

## ② Investigations toward the creation of a UIDF

### (Basic Policy for Creating the UIDF)

As a basic policy for creating the UIDF, the WG decided to use the model format by the Workshop on Securitization as a base for RMBS, ABS, and CLO products, and make the necessary revisions. For CMBS, the WG decided to use the proposed format being produced by CMSA-Japan based on discussions with multiple stakeholders.

As a first step in the creation of the UIDF, up to the interim report point, the WG created a working draft on the priority information necessary for the risk-return analysis of investors. Commencing this fall, the WG will reflect the views of the securitized product originators that will be providing the information and produce a finalized version of the UIDF while taking into consideration overlap with statutory disclosure.

### (Producing the working draft)

A Unified Information Disclosure Format Initiative Team, comprising 11 members including investors, originators, distributors, rating agencies, and others (Actually, two observers also participated) was commissioned by the WG to produce the working draft. The initiative team made their report on the working draft to the WG at the 6<sup>th</sup> meeting on June 5 2008.

### (Information by investors to do risk/return analysis)

Before beginning the activities of the initiative came, the WG received the following explanation by securitization analysts of the information investors need to make their own the risk/return analysis.

#### (1) Necessary information regarding securitization of monetary claims

- As necessary information for credit risk analysis when investing, the “Level 1” and “Level 2” items in “1.Disclosure at point of issuance” in the Workshop on Securitization’s model format are extremely important. There are almost no items that can be omitted.
- Based on the fact that most RMBS in Japan have fixed interest rate coupons, information in “1.Disclosure at point of issuance” in the model format does not necessarily cover sufficiently the necessary information for making interest risk analysis when investing.
- The necessary information for making investment return analysis when investing is covered to a certain degree by “1.Disclosure at point of issuance” in the model format (expected cash flow

included prepayments is not covered). In addition, there is a lack of information about multiple existing issues of the same type that could be used for comparison.

- As necessary information for monitoring credit risk after an investment, the “Level 1” information in “2. Disclosure following issuance” is extremely important. On the other hand, there is room for paring down items in “Level 2.”
- Because it is possible that the necessary information could change depending on changes in market conditions, etc., there should be some flexibility to enable revisions in the format.
- The necessary information for monitoring interest rate risk and calculating return is market price.

## (2) Necessary information regarding securitization of real estate

- In the U.S. and Europe, CMBS transactions are typically backed by about 100 properties. In this case, investors do not necessarily look at the details of each property. Among the ways at look at the investment is checking the main properties only based on the degree of diversification. Ratings are also being used in conjunction with the information provided by originators and others to make the investment decisions. This, of course, is based on receiving information from the rating agency on what information was used in making the rating and what were the assumptions used. Taking these views into consideration, the minimum information items necessary when putting a deal together are as follows (in the case of multiple property issues, in addition to these points it is necessary to look at the effectiveness of the overall portfolio and what type of special characteristics it might have).

### [Individual property (underlying assets) level]

Basic information: property name, property type, location, construction date, total floor space, rented area, land area, number of floors, property manager, ownership type (ownership, leasehold, etc.), PML, etc

Performance: occupancy rate, grows revenues, NOI, NCF, etc

### [Loan level]

Basic information: borrower, loan date, maturity date, balance (original, current), principal repayment method, interest rates and payments, collateral, LTV etc

Performance: DSCR (historical figures, trigger figures) and the existence of other trigger conditions and, etc

Reserves: types of reserves and balances, etc

### [Bond and beneficiary right level]

Basic information: structure (capital structures, method of principal repayment <timing and amount>, existence of swaps, definition on event of default, various contract items <rights of each class, transfer restrictions, etc.>, existence of other trigger conditions, cash flow (WAL, final payment date, payment window), etc

### [Rating information]

Rating agency's credit risk assessment of each process

- The information items necessary during the life of the product are related to the cash flow of the property and to how the asset pool of the portfolio is changing. Specifics are as shown below.

### [Individual property (underlying assets) level]

Basic information: property name, property type, location, construction date, total floor space, rented area, land area, number of floors, property manager, ownership type (ownership, leasehold, etc.), allocated loan amount, PML, etc

Performance: occupancy rate (cut off date, current figure), grows revenues, NOI, NCF, etc

Sale of property: basic information on property (as shown above), sales price of property

Acquisition of substitute payment property: basic information (as shown above), performance, etc  
(as shown above)

[Loan level]

Basic information: borrower, loan date, maturity date, balance (original, current), principal repayment method, interest rates and payments, etc

Performance: DSCR (historical figures, trigger figures) etc

Special conditions: trigger breaches, property sales (property name, release value), changes in conditions, major changes in performance, others (fire damage, etc.) etc

Overdue conditions: days in delayed payment, principal amount of delayed payment, interest rate, delayed payment penalty, etc

Reserves: types of reserves and balances, etc

Servicer advances: amounts and breakdown, etc

[Bond and beneficiary right level]

Basic information: balances, payment schedules, credit support, etc

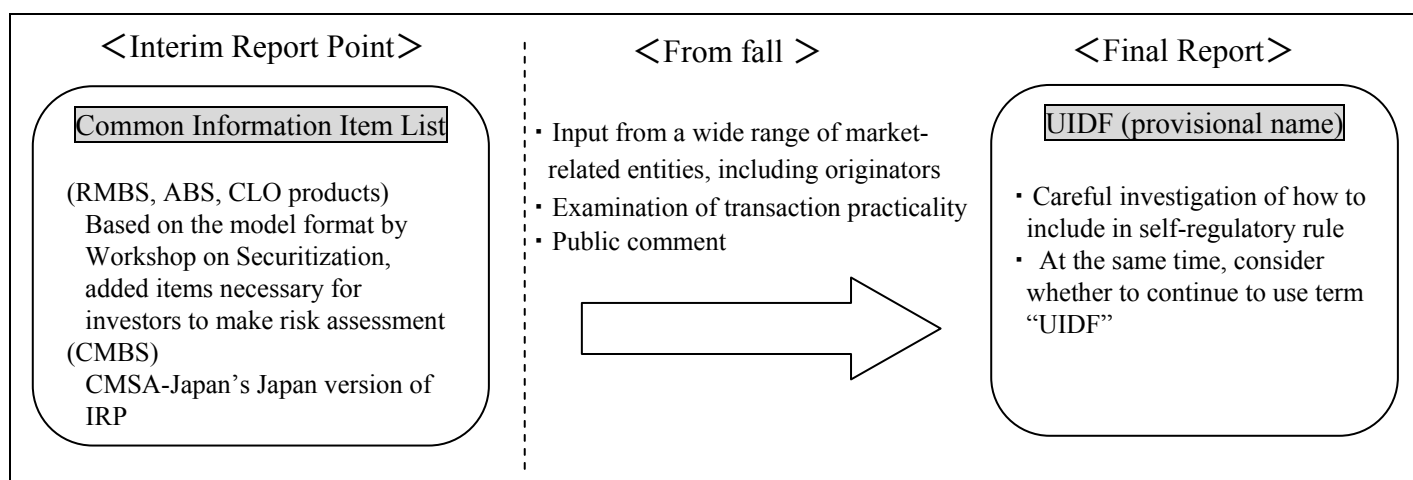
### ③ Common Information Item List

#### (Positioning of Common Information Item List)

During the 6<sup>th</sup> meeting of the WG held on June 5, 2008, the leader of Unified Information Disclosure Format Initiative Team reported on the working draft they had prepared. Because the Initiative Team did not discuss format (style, input, structure) but rather what should be on the information list, to make a clear distinction from the UIDF that is the final product of the WG, it was decided to call the working draft the “Common Information Item List.”

Beginning in the fall, the WG will use the “Common Information Item List” as a base during the process of making the list more practical by reflecting the opinions of a wide range of market related entities, including originators, while also proceeding with more focused investigations from the perspective of the practicality of transactions. After that process, the WG will discuss how to include its findings in the JSDA self-regulatory rules. For example, it will be necessary to carefully consider whether in terms of the future “format,” details right down to the order of items in the written format should be directly included in the self-regulatory rules. At the same time, the WG will consider whether or not to continue to use the term “Unified Information Disclosure Format.”

#### Creation Process for Unified Information Disclosure Format (provisional name)



## (Outline of Common Information Item List)

### (1) RMBS, narrowly defined ABS, CLO products

The Initiative Team considered format based on the model format by Workshop on Securitization.

The Initiative Team carried out its discussions with products that are considered typical in Japan in mind. What types of products are considered typical was not discussed by the Initiative Team, but for RMBS the Initiative Team supposed they were securitized housing loans (where the debtor is not limited to individuals putting up their own homes for collateral, but also includes apartment building loans and condominium loans for investment purposes) where financial institutions or non-banks (including so-called mortgage banks) are the originators. For narrowly defined ABS, the Initiative Team supposed they were securitized lease claims, credit claims, cash advance claims and other receivables. For CLO products, the Initiative Team focused on securitized corporate loans of financial institutions, but also included the so-called “managed” securitized products.

Information items for each type of securitized product are divided into three levels. Most of the items in “Level 1” are thought of as necessary, while “Level 2” includes information that is useful and desirable to be included in the discussions. “Level 3” contains useful information items but with lower priority than those of “Level 2.”

Compared with the model format by Workshop on Securitization, the Common Information Item List has added a few items. Among the added items, “Product Name” (a name that specifically defines the product) was included because of the problem of different naming and contract numbers used by different distributors of investment trusts on identical product. The Initiative Team thought it was undesirable to have different names, symbols, and numbering for identical trust beneficiary interest. In addition, the Initiative Team believes that in this case rather than relying on just the symbols and numbering, it was important to have proper names with certain meanings.

### (2) CMBS

Because the Standards Report of the Standards Subcommittee of the Japan Office of CMSA is still in process, at the interim report stage, the WG conducted a hearing with CMSA-Japan, receiving a briefing on the process and production of its Standardized Report. At this point, the WG has reached the tentative conclusion that CMSA-Japan’s information is at a level where it may be useful in the formulation of JSDA self-regulatory rules. Therefore, the content produced by CMSA-Japan has been included “as is.”

### (Remarks regarding the Common Information Item List< RMBS, narrowly defined ABS, CLO products>)

The Common Information Item List has been created without consideration for what purpose it will be used for or who will communicate the information to whom. Therefore, the list includes items that are generally generated by servicers and others and communicated to investors by rating agencies and trustees. In addition, the list contains items that even if they exist may not necessarily be accessible by distributors.

Although discussions have been conducted with products that are considered typical to Japan in mind, because actual securitized products differ in nature and individual characteristics, there is a limit to their commonality and a unified approach is not appropriate.

Since the definitions used for level categorization have not been closely examined by the Initiative Team, the comparative degree of priority for each item will differ depending on the special features of the product, situation of the person using the information, and the purpose of the use of the information. For example, there will be a significant difference in the scope and depth of information required for risk assessment of securitized products backed by the same assets by investors holding senior class notes with a subordination of 20% and a tranche size of 80% and by investors holding subordinated class notes with a subordination of 5% and a tranche size of 5%.

The Common Information Item List does not include information items necessary for a certain portion of risk nor for evaluating return on investment. In other words, for assessing the major portion of interest rate risk and for evaluating investment return, it is essential to have reliable pricing information. Since this pricing information (reference prices for assessors at financial institutions, quotations, disclosure prices, and other price evaluations) is not inherent in the product, but derived afterward externally as necessary at the time of issue and post-issue, it was considered to be inappropriate for inclusion in the Common Information Item List, and therefore not included.

(Items that while being discussed by the Initiative Team were not included in the Common Information Item List)

Within the discussions of the Initiative Team an opinion was expressed that information regarding the verification of claims related to underlying assets should be provided to investors. This information is not necessarily the content of “comforting procedures,” but information indicating whether the procedures have been carried out or not. If they have, the name of the audit firm that conducted the procedures, if not some information whether or not the distributor based on something other than the certification from the originator that provides some verification should be provided to investors. There were opinions that the content of “comforting procedures” is not disclosable to investors or third parties. In addition, the opinion was also expressed that distributors generating information in the process of their underwriting screening have no intention of communicating it to third parties, and in fact it was not practical to provide this information to third parties, including investors.

Conversely, the opinion was expressed that if the Common Information Item List is used to communicate information to investors, from the point of view of managing the term of information for investors, the frequency, timing, and process (monthly, semi-annually, approx. dates, by facsimile or through information vendors, etc.) of information communicating should be made clear beforehand.

(Remarks regarding the Common Information Item List <CMBS>)

In considering the use of the Standardized Report being prepared by CMSA in the Common Information Item List for CMBS, the large difference in the legal significance between the voluntary use of the Standardized Report by CMSA members and self-regulatory rules imposed under the FIEL should be taken into account. In addition, the use of the items on the list should be carefully considered from the point of view of whether it is appropriate for self-regulatory rules.

#### ④ Ensuring accuracy of information

In recognition of the issue of ensuring the accuracy of information when promoting the communicating of information by distributors, the WG invited a certified public accountant (CPA) to make the following presentation. In meetings up to this point, the discussion of points on this issue has been limited to the explanation given below. More detailed discussion is planned when meetings start up again in the fall.

(Presentation by a certified public accountant)

Looking at the disclosure items audited by CPAs, on the surface the items related to securitized products can be broadly divided into 1) checks of external vouchers and disclosure items and 2) checks of information creation processes. Out of the two, 1) is relatively easy to do, while 2) it is difficult because the reliability of the internal documentation cannot be ensured.

The types of audits done by CPAs in inspecting these disclosure items can be broadly divided into 3 types 1) reviewing the accuracy of disclosure documentation, 2) following Agreed Upon Procedures related to the accuracy of disclosure documentation, and 3) auditing the establishment and operation of the internal control system related to the process of producing the information for disclosure documentation (SAS 70 administration, auditing of internal control systems based on Auditing Standards Committee Statement No. 18).



In 1), a specific standard is applied to determine where there are any matters that could be considered inappropriate in the information disclosure based on applying a specific standard, and communicating them (limited guarantee). Although this method has the advantage of receiving an opinion on the accuracy of the disclosure documentation by the auditor, it has the disadvantages of requiring the setting of implementation standards appropriate for information disclosure of securitized products and generally higher costs than Agreed Upon Procedures (AUP). Because of this, this method is almost not used at all.

For 2), the auditors implement procedures agreed upon with the client business, and report on the results. The audit report is only on the AUP and the CPAs do not make any conclusions. The company requesting the procedure takes responsibility for deriving any conclusions from the implemented procedure and results. In addition to the setting of a standard, the advantage here is generally lower costs compared with a review. The disadvantages are the auditor gives no opinion on the accuracy of the disclosure documentation and the report is not made widely available for public inspection because it is reported only to the client.

In 3), the CPA audits the structure and operation of the internal control system and makes a report. Employees preparing the disclosure information prepare a written statement on the structure of the internal control system on which the audit is then based. The advantage here is that the auditors give an opinion on the structure of the internal control system. The disadvantages are employees preparing disclosure information must prepare a statement on the structure and operation of information creation processes under the internal control system and the cost is generally higher than either a review or AUP inspection.

#### (6) Establishing procedures for evaluating, calculating, and communicating theoretical prices (Ongoing discussion on the positioning of self-regulatory rules)

##### ① About JSDA guidelines

The WG discussed establishing procedures for evaluating, calculating, and communicating theoretical prices. Although it does not cover theoretical prices, there are JSDA guidelines for the provision of market prices of financial instruments by securities companies, “Points for Securities companies to Consider in Providing Market Price Information (Hereinafter referred to as “JSDA guidelines”) (August 2000). Therefore, the WG reviewed the content of the JSDA guidelines.

According to the JSDA guidelines, in “I. Basic Principles for Providing Market Price Information, 3. Establishing Procedures for Providing Market Prices,” JSDA members shall establish internal procedures for accurately providing market prices to client companies.

Moreover, “II. Remarks on Providing Market Price Information, 2. Remarks on Members to Watch When Providing Market Price Information” states the following.

When providing market price information to client companies, members shall not be arbitrary and shall be careful about the following points in endeavoring to collect or evaluate and calculate information in an objective and rational manner.

- (1) In providing market price information, members shall determine beforehand internal procedures regarding the method, etc., of providing to client companies.
- (2) Members shall disclose beforehand whether the market price information is evaluated or calculated market price or publicly announced market price when providing market price information.
- (3) For publicly announced market price information, the client companies shall, in principle, get the information themselves using the provided method of accessing the public materials. Should the member get the information for the client company, the member shall provide details of the source of the information, such as the media or location it was taken from, when providing the publicly announced market price information to client companies.

- (4) For market price information that has been derived by evaluation or calculation, a member shall use methods set out in the practical guidelines to evaluate or calculate market price. Moreover, in order to avoid being arbitrary and to contribute to a fair evaluation or calculation of market price, the member shall observe the following points.
- ① Even when requested by a client company to provide an evaluation or calculation of market price, if the member receiving the request decides that it would be difficult for it to make a rational evaluation or calculation of the market price, the member shall explain the situation to the client company and not provide the requested evaluated or calculated market price information.
  - ② With the exception of the case of refining an evaluation, a member shall not tamper with its method of evaluation or calculation if so requested by the client company.
  - ③ When providing market price information based on an evaluation or calculation, a member shall clearly indicate the type of evaluation or calculation (median rate, exit price, etc.) and provide the information using the following method.

In the “Outline of Comments on Proposed Revision to Supervision Guidelines and FSA’s View of Comments” announced on April 2, 2008, the following sections were related to the relationship between the Supervision Guidelines and the JSDA guidelines.

No.	Outline of Comments	FSA’s View
22	<p>On establishing “procedures to evaluate and calculate theoretical prices and provide them to clients smoothly and accurately even if it is difficult to specify a market price.”</p> <p>In II 2. (4)① of the JSDA guidelines produced by the JSDA in consultation with the Japanese Institute of Certified Public Accountants it is stipulated that “if the member decides that it would be difficult for it to make a rational evaluation or calculation of the market price, the member shall explain the situation to the client company and not provide the requested evaluated or calculated market price information.” With no consultation going on between the two associations regarding the revision of the guidelines, we can’t avoid the impression that the proposed supervision guidelines have jumped to a conclusion and would like this to be corrected.</p> <p>In I 2. of the guidelines, securities companies are required to make efforts to provide market price information. Since the intensification of the proposed supervision guidelines appears to be to create an obligation to provide market price information (rather than best efforts) despite no talks as yet between the two associations regarding revisions of the guidelines, just to be sure, we would like to confirm this is not the case.</p>	<p>The intention of the stated “establishment of procedures” to provide prices is to focus on the point of whether or not it is possible to meet the requests of clients for price provision and not to create an obligation to provide prices. Nor is it intended to overrule the provision in the JSDA guidelines that “if the member decides that it would be difficult for it to make a rational evaluation or calculation of the market price, the member shall explain the situation to the client company and not provide the requested evaluated or calculated market price information.”</p> <p>In the JSDA guidelines, it is stipulated that members “will establish internal procedures to provide market price information to client companies in a timely manner.” The provisions of our supervision guidelines are based on that rule.</p>

Furthermore, in the WG, a representative of the FSA made the following explanation of the relationship between the Supervision Guidelines and the JSDA guidelines.

- The Supervision Guidelines were formulated with the “price evaluation and market price calculations” in the JSDA guidelines in mind. Of course if you look closely at the “theoretical price” in the supervision guidelines and the “market price” in the JSDA guidelines, there are possibly

differences. In that sense, it is perhaps necessary to brush up both the supervision guidelines and the JSDA guidelines, but at any rate we don't see any major differences.

- The supervision guidelines are asking distributors to establish procedures basically like the “price evaluation and market value calculations” in the JSDA guidelines and that they do not make arbitrary price valuations and calculations. For those reasons, no new content was put forward, but attention was focused on supervision, particularly of securitized products, in lieu of the recent subprime loan problem.

## ② Treatment of liquidity risk

In the third meeting of the WG, a representative of the Japanese Institute of Certified Public Accountants (JICPA) gave a presentation on auditing the evaluation of securitized products. He stated that when auditing the evaluation of securitized products held by investors, under current accounting standards “fair value” was the cash involved in the purchase or sale. He wanted this market value to reflect not only credit risk, but also, depending on the situation, liquidity risk. However, there is no definitive answer currently as to how to add in liquidity risk. He explained that in the practical guidelines for financial instruments, while the basic stance was that liquidity risk should be included to a certain degree, it had to be decided on a case-by-case basis. In response to this explanation, a representative of the FSA said that their focus on the supervision guidelines is that the calculation method shall not be arbitrary. The FSA does not have specific requirements on what aspects should be factored into prices. The FSA representative said that with liquidity risk as well, they were not necessarily requiring it to be included in price—their goal was for the risk involved to be clearly explained.

## ③ Future direction of discussions and issues

Based on the above, the WG decided to move forward with the concrete realization of the Supervision Guidelines’ “Establishing procedures for evaluating, calculating, and communicating theoretical prices of securitized products” based on the current JSDA guidelines. Discussions will continue on whether to use the JSDA guidelines “as is” or to link them in some way to self-regulatory rules. In addition, the WG plans to consider the possibility of cooperating with others to ensure there is no variation with the accounting treatment of theoretical prices of securitized products, such as collaborating with the Accounting Standards Board of Japan (ASBJ).

## (7) Supplemental Discussions (Point which cannot be included in self regulatory rules)

The WG held hearings with related parties regarding the roles of rating agencies and information vendors in the communication of securitization market information and held discussions. Although the discussions will not be directly reflected in the future formulation of self-regulatory rules, they contained many suggestions of how the information infrastructure of this securitization market would evolve along with the progress in information disclosure for securitized products. When considering the role that distributors should play in communicating information about the securitization market, it is extremely important to first explore this aspect of the market.

### ① The role of rating agencies in communicating information about the securitization market

Under the Supervision Guidelines, distributors are required to establish proper information communicating procedures for securitized products. However, in the actual securitization market, in addition to distributors providing information, rating agencies have an extremely important role in communicating information about the market. For distributors, the rating agencies are also important from the point of view of efficient communicating of information required by investors by distributors adding their own supplemental information to that of rating agencies. From this perspective, in recognition that before formulating self-regulatory rules for distributors the WG should obtain an

understanding of the role of rating agencies, the WG invited rating agencies to make presentations and held discussions.

(Information items considered important by rating agencies)

When determining a credit rating for securitized products being issued or during their terms, rating agencies consider the following information items to be important. Therefore, for the items listed below, it is thought that even if they are not all reported in their exact form, the information is reported to investors through the analysis of the rating agencies.

(1) Information items rating agencies consider important when first determining a rating

(Securitization of monetary claims)

- Credit risks of related parties (ratings of parties related to swap counterparties and trigger counterparties)
- Details of bond issue (details of structure, issue conditions<term, interest rate, etc.>, cash flow waterfall, etc)
- Details of asset pool (default rate, credit rating of individual assets <primarily when pool is small>, prepayment rate, cancellation rate <only if available>, repayment rate <only if available>, interest rate scenario <only if available>, surplus income <only if available>, asset pool grouping information, cash reserves, etc)

(Securitization of real estate)

<Property level>

- Real estate assessment report, engineering report (including earthquake and environmental risks), rent roll, prior performance history, market report (only when necessary), and individual documents on a case-by-case basis, such as Q&A documents, documents on properties similar to one being rated, generally available rental fee information, and submarket information)

<Loan level>

- Full set of loan contract documents (including legal opinion), loan summary, due diligence of sponsor and asset manager

(2) Information items monitored by rating agencies during product term

(Securitization of monetary claims)

- In their monitoring operations, rating agencies monitor the deal-related entities (monitoring of events arising from scheme-related entities and changes in credit worthiness), and individual products (checking of performance and changes in credit worthiness <checking of appropriateness for standard scenarios>, adequacy of supplementary credit), and they conduct surveys regarding the necessity of adjusting credit ratings by redoing simulations.
- The information items considered important by rating agencies for making adjustments in ratings are the same as for determining the original rating. However, they face different issues compared with the original determination. While they can now receive very recent performance information, they face such problems as group data being difficult to obtain at specific monitoring point (different types of ranges, loan-by-loan data) and a time lag in the information.

(Securitization of real estate)

<Bond Level>

- The dividends calculation period and payment date, principal (closing and maturity balances, amortization amount during term, prepayments amounts, dividends (dividend ratio for each class <coupon rate> and dividend amount <coupon amount>, reserve amount (balances upon closing for each category of reserve, reversals during the term, at maturity balance), each type of expense

(trustee fees, servicer fees, etc.), advance information when an contractual advance is made (advance balance upon closing and at the maturity, interest rate applied to the advance, advance repayment amounts, etc)

#### <Loan Level>

- The interest rate calculation period and payment date, interest (interest rate on each loan <fixed or floating rates>, interest payment amounts), reserve amount (balances upon closing for each category of reserve, reversals during the period, balance at maturity), prepayment (in the case that an prepayment occurs during the term, the date of the prepayment, the reason <sale of real estate or refinancing, etc.>, and notes regarding early redemption amount), each type of trigger (for example, DSCR trigger or LTV trigger. In the case of a liquidation type loan, the disposition trigger, etc.), the arrears information in the case that default occurs (arrears penalty, accrued interest, accrued principal, arrears conditions<for example, less than 30 days of default, 30 or more days but less than 60 days of default, 60 or more days but less than 90 days of default, 90 days or more of default>, watch list (even with normal assets, there are events that raise concerns about current conditions, future loans or repayment of special bonds<for example, trigger conditions>, which are on this list. It is also desirable that future policies regarding these events be noted.)

#### <Property Level>

- Communicating term, real estate income and expense information (same information as original assessment desirable<rental fee levels, operating rates, income amounts, expenses amounts, NOI, CAPEX, NCF, etc.>), rental fee arrears information (arrears amount, number of properties, arrears conditions<for example, less than 30 days of default, 30 or more days but less than 60 days of default, 60 or more days but less than 90 days of default, 90 days or more of default>. For major tenants, confirmation of response to the situation is necessary.), large-scale maintenance information (necessary to verify the needed maintenance is properly carried out), tenant moves and credit information (major tenants' domiciles. Past information, leasing conditions, more recent rent roll, financial-related information <as necessary for single tenants or major tenants>), real estate sale information (if underlying real estate assets are sold, the sale-related information), listing of events that could have a major impact on the value of underlying real estate assets (for example, a report may be requested on details of the necessary construction, construction period and costs, and provision for construction expenses if a building is damaged in an earthquake.)

#### (Role of rating agencies)

The following are the roles that rating agencies are thought to play in communicating information on securitized products.

##### (1) Acting as a common language for credit risk

Investors use their own evaluation standards in making credit risk assessments. However because different investors have different standards, it is not simple to compare credit risk of the same product. By acting as a common language for credit risk, credit ratings make it easy for investors to assess credit risk among themselves. This is thought to contribute to improving the efficiency of the market.

##### (2) Abundant information

It is generally believed that rating agencies have more information than investors. Rating agencies have the information provided to them to determine ratings for individual deals, accumulated knowledge from doing due diligence, and depending on the type of information, they may have access to information from originators that originators would find difficult to disclose to investors.

##### (3) Improving efficiency of investor's investment decision and monitoring of products during their terms

For investors that require a more efficient investment examination, it is possible that they can more efficiently obtain access to resources necessary to their investment decision and the monitoring of

products during their terms by using the information from the rating agency on its analysis methods and assumptions.

Rating agencies do not merely designate a rating figure; they also provide the criteria on which they base their rating analysis to the investors. By checking whether a rating exists or not, investors can conclude which criteria were met or not (supposing this information was not available, investors would have to investigate individually a gigantic number of information items, possibly resulting in extremely high costs and time for them and originators).

#### (4) Provision of macro information

Investors can use the performance information by asset type provided by rating agencies and their research reports to gain information on the broad trend of overall products in the same asset class as securitized products they hold. Moreover, rating agencies also research the impact on securitized products of changes in legal systems as well as current topics and provide their perspectives on these issues to the market.

#### (5) Contributing to the greater transparency of the securitization market

Since the analysis methods of individual investors are not disclosed, if there were no rating agencies it would be difficult to see in what way the risks of the securitization market were being analyzed, possibly resulting in a less transparent securitization market.

#### (Remarks on ratings of securitized products)

However, rating agencies base their ratings on information provided by originators and others and the opinions of external experts and other information sources. Therefore it is necessary to be careful about the assumptions used in rating securitized products and the limitations of the ratings.

#### (1) Risks not reflected in ratings

- Risks other than credit risk, and not contained in the securitized product, for example, liquidity risk, price fluctuation risk, volatility risk, etc
- The risk that the information obtained by the rating agency is inaccurate
- The risk that entities involved with the scheme may take fraudulent actions
- Tax risks, such as changes in the taxation system (however, in the original rating assessment on cash flow analysis, rating agencies review tax opinion and other documents which examine this risk.)

#### (2) Limitations of the assumptions and conditions of ratings

- There is a limitation to the checking that rating agencies can do on the representations and warranties and comforting information received from originators.
- The rating agencies carry out an appropriateness check of the legal framework based on legal opinions and other documents provided by lawyers, but there is a limit to their consideration of the risks of changes in systems due to revisions of laws.

#### (Trend to enhancement of information provided by rating agencies)

One of the major themes regarding ratings is the opinion being expressed in the Financial Stability Forum and other areas that some differentiation should be made in the rating systems for securitized products and for corporate credit. In response, a global survey of investors was carried out by three major rating agencies. As a result, the opinion of most investors was that a differentiation shouldn't be made in the ratings. At the same time, investors wanted to see additional information provided by the rating agencies.

Consequently, the three major rating agencies announced that they would be providing supplemental information related to their ratings. In addition, some rating companies are focusing on contributing to

the credit and pricing assessments of investors by not only providing them with information, but also simulation models.

## ② The role of information vendors in communicating information on the securitization market

In future, in response to the requirement for distributors to establish procedures to communicate information on securitized products, one effective option could be the use of information vendors as a method of disclosure from the point of minimizing disclosure costs and increasing the convenience to market participants. Information vendors would not be required to do so by regulations, but would voluntarily enhance their disclosure to third parties. In recognition of this issue, the WG held hearings with two major information vendors regarding the current state of and outlook for providing information on securitized products. They received the following explanations from the two companies.

(Presentation by A company)

All of the Japanese securitized products issued since April 2007 (Japanese collateralized asset base, on a yen basis), 46 products are registered on our “Mortgage Sector.” Of these issues, 34 provide projected cash flow. In addition, 15 products are private issues and have restricted access to the information.

Among securitized products, at the wish of sellers, some products have been registered in the “Corporate Sector” rather than the “Mortgage Sector.” Because in technical terms multiple cash flow scenarios cannot be done in our “Corporate Sector,” they are not able to conduct default early redemption trigger analysis.

We only provide asset performance data in Excel format for the RMBS of the Japan Housing Finance Agency (JHFA). The rest is in PDF format, and have to be converted to Excel files for users to make use of them. In the United States, however, asset performance data is stored as digital data within our analysis tools, allowing users to change the data format without any problems. This makes it possible to do many varieties of credit analysis using the analysis tools. Since this WG is considering a unified information disclosure format, we are hoping to be able to load asset performance data as digital data and provide analysis tools in Japan just as we do in the United States.

In the United States, users have access to a “Super YT Function” that allows them to calculate yields and duration based on their own assumptions about the underlying assets.

For CMBS products in the United States, the information even includes mortgaged property data. In Japan, however, we do not do this because information disclosure on CMBS is not necessarily sufficient. For J-REIT products, on the other hand, information disclosure is improving, and we started providing mortgage property data in March of this year.

The CDO that have been pointed out among U.S. securitized products as having a particular problem with traceability are premised on nondisclosure, and there is no information available even in the United States. Among secondary securitized products, the trend in United States in dealing with traceability is to expect solid disclosure of the primary securitized products and to carefully scrutinize those that seemed to have a problem with the underlying assets.

(Presentation by B company)

The information we disclose is the basic items at the time of issue, ratings information, price, prospectus, structure diagram, etc. For the JHFA RMBS, we add cash flow data for entrusted assets, rescheduling factors, and historical data in a downloadable Excel format.

RMBS of the JHFA have the following special features: 1) as originator, the JHFA directly provides the vendor with timely data when pools are originated and on an ongoing basis, 2) detailed prospectuses and structure are made public, 3) its prices are used in buying and selling reference statistics and quoted by many securities companies, and 4) a certain level of standardization is carried out for the information items they provide, which has helped vendors in building information screens for their system.

We provide evaluation tools for the RMBS of the JHFA. When we asked customers (wide range of customers covering from major institutional investors to regional financial institutions) what they thought of these tools, their response was generally favorable. Most major institutional investors have their own evaluation tools; therefore, they have an interest in our tools for management purposes. For trading, particularly upon launching, they also find them useful in discussions with the securities companies distributing the product based on the use of a common OAS. Of course, customers who do not have their own evaluation tools use our tools not only for sales but also for management.

We have had requests from our customers to provide these tools for not only the JHFA RMBS, but also RMBS of commercial financial institutions. We believe this would be difficult because commercial financial institutions do not disclose information on their RMBS in a standard or continuous way. Conversely, if a wide range of securitized products started to make standardized and continuous information disclosure, the scope of use of our evaluation tools would broaden and contribute to improved convenience for customers.

## 5. Future Issues

The following is a list of the future issues remaining to be dealt with at the time of the interim report. They will be dealt with in accordance with “6. Rough Schedule for Fall Onward”.

### (1) Scope of securitized products (Point related to the direction of self-regulatory rules)

#### ① Scope of the securitized products covered by the Supervision Guidelines (= scope of securitized products to be covered by WG discussions)

The interim report states that almost all securitized products are covered by the supervision guidelines, with the exception of the products where there is clearly no problem with traceability as noted in (1) to (5) in 4. -(3)-① “Scope of the securitized products covered by the Supervision Guidelines” of this report.

The following issues remain regarding this topic.

- Conclusions on securitized products for which there is thought to be no problem with traceability (deliberations and conclusions on the products noted from (1) to (5) in 4. -(3)-① “Scope of the securitized products covered by the Supervision Guidelines.” In addition, the WG needs to work out the details on other securitized products that are outside the scope of the Supervision Guidelines.)
- Determine a clear definition of structured bonds/notes.
- Clarify the definition of collective investment schemes.

#### ② Scope of securitized products covered by the UIDF

The four types of primary securitized products are covered by the UIDF stated in 4. -(3)-② of the interim report. The following issues remain regarding this topic.

- Consider the possibility of creating, stylizing, and standardizing a UIDF for securitized products not covered by the UIDF of the interim report (primary securitized products other than the stated 4 types of assets, equity < preferred equity investments > types of securitized products, and secondary securitized products).

#### ③ The scope of securitized products to be covered by the JSDA self regulatory rules

Of the scope of securitized products covered by the supervision guidelines of the FSA, the scope of securitized products to be covered by the JSDA self-regulatory rules to be formulated by the WG is limited to the securities as defined by Article 2, Paragraph 1, of the FIEL. Representative products are



“corporate straight bonds” and “preferred equity investments” (see 4. - (3) -③). The following issues remain regarding this topic.

- Irregardless of the type of product, based on the thinking that it is most appropriate to set up wide reaching and fair rules, the WG should make some recommendations regarding treatment of the securities outside the authority of the JSDA, such as securities equivalent (deemed securities) stipulated by Article 2, Paragraph 2, of the FIEL and ABLs outside the scope of the FIEL.
  - For example, it is possible that the WG could recommend that the FSA apply the same self-regulatory rules being formulated by the WG to “securities equivalent” or set up regulations, etc., for banks and lenders with a similar impact to its Supervision Guidelines for financial instrument businesses.
  - It is also possible that a section with the same instructions regarding handling of bonds, etc., could be included in the self-regulatory rules of the JSDA regarding distribution of “securities equivalent” securitized products by its members.

## (2) Establishing internal procedures to collect and communicate details and risks of underlying assets (Point related to the direction of self-regulatory rules)

### ① Investigation on an actual transactions basis

“Perspectives on methods of communicating information” in Section 4. – (4) – ① of this report provides no more than an indication of the direction to be taken in establishing a procedure for the collection and communicating of information regarding underlying assets and related risks, adequate discussion has not been made regarding practical transactions. In response to this issue, commencing in this fall, the WG will conduct a full investigation of the detail aspects of actual transactions leading up to the formulation of self-regulatory rules.

In particular, principally in the case of secondary products, distributors that are only distributing products and not originating them do not necessarily have the same information as arrangers regarding the collection and communication of information regarding underlying assets and related risks. The WG needs to discuss how its procedures should operate in such circumstances.

### ② Required level of human resources and organization

Because it involves management decisions by individual companies, it is difficult to make an all-encompassing statement regarding the required level of human resources and organization to be achieved by distributors when establishing procedures for communicating details and risks of underlying assets. Nevertheless, because in addition to the WG being requested by the authorities to establish procedures it would serve as a reference for distributors newly entering the securitized product market, the WG will investigate if there is some way in which it can suggest level of human resources and organization than should be aimed for.

## (3) Unified information disclosure format (provisional name) (Products related to the direction of self-regulatory rules)

### ① Creation of the UIDF

Based on the Common Information Item List in this interim report, the WG will create a UIDF. The following are the issues regarding that process.

- Make the UIDF more practical by reflecting the opinions of originators, etc.
  - For example, the WG could conduct a survey of originators regarding its interim report and reflect the opinions received in its work.

- Carry out a detailed investigation from the perspective of actual transactions (consideration of items and written format). Also investigating procedures for that case in which the distributors distributing the product are not the arrangers.
- Investigate consistency with statutory information disclosure items.
- For CMBS, hold hearings with banks regarding the possibility of using CMSA's IRP in cases where the bank is both the originator and the servicer, and investigate the issue.

## ② Investigations aimed at ensuring practicality

In addition to investigations of the content of the UIDF, the following issue exists regarding ensuring the practicality of the use of the UIDF.

- Request cooperation of originators that are providing the information in some form.

## ③ Investigations on how to include the UIDF in the self-regulatory rules

In deciding how to include the UIDF in the self-regulatory rules, careful consideration will have to be made of the following points.

- Although at this point the UIDF is only being created as a reference format for the self-regulatory rules, the WG will have to consider whether to:
  - ① In terms of regulations, make the UIDF only a “reference” format, and although the UIDF's order of items and other aspects of the written format will be strongly recommended as a progressive method of communicating information, there will be no obligation to use the UIDF, or
  - ② Make the UIDF and its order of items and other aspects of the written format a requirement in terms of regulations, and include text to that effect in the self-regulatory rules.

→ It will be necessary to clearly differentiate between enlisting the proactive standardization of format carried out by market participants for minimizing the costs of communicating information and increasing convenience, and formalizing these procedures by imposing requirements under the self-regulatory rules.
- In terms of format, there are products where the production of explanatory materials in accordance with the statutory disclosure format has become commonplace even for private placements. It will be necessary to consider carefully the consistency of statutory and market practices.
- For CMBS, the WG is proceeding in the direction of using the IRP of CMSA as the UIDF. However, as stated above in addition to investigations regarding the broad ranging use of the UIDF, the WG should consider whether to:
  - ① Require in the self-regulatory rules only a format “with the same content as the IRP” to be used as the UIDF, or
  - ② Require in the self-regulatory rules “the exact” IRP of CMSA to be used as the UIDF.

→ Should ② be chosen, in addition to using the self-regulatory rules to determine even the written format of the UIDF, an issue will arise regarding the management of the IRP because the CMSA is independent of the JSDA. The WG will have to consider some measures to deal with this relationship.

→ If the IRP of the CMSA is included in the JSDA's regulations “as is,” the WG will have to carefully consider the differences in the legal nature and interpretations of the IRP, which is a standardized form used voluntarily by the private sector members of CSMA, and the self-regulatory rules based on the FIEL. In selecting the disclosure items, the JSDA should investigate carefully and independently (including ongoing revisions following formulation of the rules).

#### ④ Ensuring the accuracy of information

The interim report stage, the WG has not carried out any in-depth discussion to address the issue of how to ensure the accuracy of information and promoting information communication by distributors. As a result, the WG will have to discuss this point in the fall.

#### ⑤ Dealing with information that cannot be included in the UIDF

Some information that investors need to analyze the details of underlying assets and make a risk assessment cannot be included in the UIDF. The WG needs to discuss a solution for this situation.

#### ⑥ Periodic revisions

Information that investors need to determine the details of underlying assets and make a risk assessment or information originators can disclose— in other words the appropriate content for the UIDF— may differ over time because of changes in the economic environment, laws, accounting standards, and other factors. Therefore, even after the introduction of the UIDF, there will have to be periodic revisions. As a more immediate problem, even directly following actual creation of the UIDF, the possibility of practical problems arising that require revision of the UIDF cannot be excluded. Consequently, the WG will have to deal with the following issue.

- Determining rules for revisions (body to carry out revisions, timing of revisions, revision process, etc.) following the introduction of the UIDF.

#### (4) Establishing procedures for evaluating, calculating, and communicating theoretical prices (Ongoing discussion on the positioning of self-regulatory rules)

##### ① Specific procedures

In meetings up to this point, although the WG has decided on moving in the direction of using the current JSDA guidelines as a base for realizing the Supervision Guidelines' "Establishing procedures for evaluating, calculating, and communicating theoretical prices," no discussion has been made of specific procedures. As a result, the WG needs to discuss the following points.

- Should the JSDA guidelines be included "as is," or should they be linked in some way to the self-regulatory rules?
- If the JSDA guidelines were included "as is," should they be included in their current form, or are some revisions necessary?

In addition, the WG will have to take some measures in consideration of maintaining consistency with the ongoing debate on price evaluations by investors by the International Organization of Securities Commissions (IOSCO) and other international conferences.

#### (5) Treatment of overseas securitized products

Ensuring the traceability of underlying assets and providing theoretical prices for overseas securitized products are difficult to address directly through JSDA self-regulatory rules. Nevertheless, because overseas-securitized products are covered by the Supervision Guidelines, the WG will have to consider in what way to deal with this issue.

- Through the FSA, the WG's final report will be submitted to various international discussion forums, such as the Financial Stability Forum. Based on this action, it is possible that the JSDA could enlist the collaboration of regulatory authorities from various countries to deal with the issue of overseas securitized products.

## (6) Method of application of the self-regulatory rules

In future, when the rules are enforced following the formulation of the self-regulatory rules, the JSDA will have to determine the treatment of securitized products distributed before the enforcement date and whether the rules will apply to all securitized products distributed on or after the enforcement date. Therefore, based on discussions starting in this fall, the WG will have to determine a policy for the method of application of the self-regulatory rules.

### 6. Rough Schedule for Fall Onward

Meeting Date and Time	Rough Agenda
September	Hearings with originators
8th Meeting September 5 15:00-17:00	<ul style="list-style-type: none"><li>Establishing procedures for evaluating, calculating, and communicating theoretical prices</li><li>Treatment of overseas securitized products</li></ul>
9th Meeting September 18 15:00-17:00	<ul style="list-style-type: none"><li>Establishing internal procedures to collect and communicate details and risks of underlying assets</li></ul>
10th Meeting October 2 15:00-17:00	<ul style="list-style-type: none"><li>Unified information disclosure format (provisional name)</li></ul>
11th Meeting October 17 15:00-17:00	<ul style="list-style-type: none"><li>Unified information disclosure format (provisional name) (continued)</li></ul>
12th Meeting October 30 15:00-17:00	<ul style="list-style-type: none"><li>Scope of “securitized products”</li></ul>
13th Meeting November 12 15:00-17:00	<ul style="list-style-type: none"><li>Final report, Self-regulatory rules (public comment paper)</li></ul>
14th Meeting November 25 15:00-17:00	<ul style="list-style-type: none"><li>Final report, Self-regulatory rules (public comment paper) (continued)</li></ul>
December	Public comment window period
15th Meeting January 27 15:00-17:00	<ul style="list-style-type: none"><li>Results of public comment</li></ul>
16th Meeting February 5 15:00-17:00	<ul style="list-style-type: none"><li>Final report, Self-regulatory rules (final version)</li></ul>
17th Meeting February 13 15:00-17:00	<ul style="list-style-type: none"><li>Final report, Self-regulatory rules (final version) (continued)</li></ul>

Note: This is a provisional schedule and subject to change.

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