

Minutes of the First Meeting of the Working Group on Distributions of Securitized Products

1. Date

March 27, 2008 (Thursday) 15:00 to 17:00

2. Place

JSDA Conference Room

3. Participants

As stated in Appendix 1

4. Agenda

- (1) Introduction of members
- (2) Outline of working group operations
- (3) Explanation of oversight policies by Financial Services Agency
- (4) Current state of disclosure and issues in the securitization market
- (5) Definition and scope of securitized products

5. Summary of Proceedings

(1) Introduction of members

The Secretariat introduced the members of the working group (WG).

(2) Outline of working group operations

The WG Chair made the following explanation of the basic principles of the working group.

- Taking into consideration the basic conditions of the economy, both the content and the scope of the securitization market in Japan are in an intermediate stage of development. In this WG we would like to conduct a basic investigation into what actions are necessary to promote the growth of the market into its proper size and what steps the industry should be taking. We also would like to conduct this investigation in a manner unrestrained by the existing framework of procedures developed by each company.
- The aim of the working group is to enable the pursuit of the following two goals by defining the Guidelines for Financial Instruments Business Supervision (the Guidelines) and by ensuring the traceability of the underlying assets of securitized products.
 - A. To forestall the occurrence of a problem such as the current subprime loan problem where it is difficult to determine the degree of risk or scope of the underlying assets of securitized products and to promote a healthy primary securitization market that will contribute to the nation's economy by establishing an environment where investors can feel confident about investing in securitized products.
 - B. To stimulate demand for securitized products among investors that have a need for domestic and foreign long-term assets 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 A. above (establishing an 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 market) and the degree of convenience as a fund raising method.
- The WG will create a format that provides a common viewpoint for realizing and standardizing information on the underlying assets and risk. Based on this format, we will ensure the effectiveness of the Guidelines (or JSDA regulations) and supply detailed information that will provide distributors with a base for establishing their internal procedures.

The WG Chair continued with the following explanation of the WG schedule.

- During the period up to June, the WG will meet on a bi-monthly basis, following which an interim report will be produced covering the overall direction being pursued in the discussions. The WG will aim to publicly release the report sometime in July.
- Commencing in September, the WG will reconvene, and will proceed to work out the details of the JSDA's regulations based on the direction stated in the interim report, completing this task by the end of the calendar year as well as compiling and publicly announcing a final report. Where possible, the WG will make every effort to complete its tasks ahead of schedule.
- Following a necessary period of preparation and information dissemination, the JSDA will enforce the new self-regulations sometime after the start of 2009.

(3) Explanation of the Guidelines by Financial Services Agency

Using the document included as Appendix 6, a representative of the Financial Services Agency (FSA) explained proposed revisions to portions of the Guidelines for Financial Instruments Business Supervision regarding ensuring traceability of securitized assets.

- The turmoil in financial markets stemming from the subprime loan problem raised two issues: 1) a short-term issue of how to dispel the underlying turmoil and 2) a medium- to long-term issue regarding the establishment of arrangements to prevent such turmoil from reoccurring. The longer-term issue is being debated internationally by the Financial Stability Forum at the request of the G7 finance ministers and central bank governors and the Subprime Task Force of IOSCO, but even in these discussions ensuring traceability, enhancing market transparency, and integrating information disclosure have been singled out as key points.
- Because the turmoil caused by the subprime loan problem in financial markets in Japan has been relatively light, discussions have revolved around the medium- to long-term issue of establishing arrangements to prevent such turmoil from happening 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 for Strengthening the Competitiveness of Japan's Financial and Capital Markets unveiled by the FSA in last December. In view of these discussions going on domestically and overseas, the FSA has prepared proposed revisions to its oversight policies.
- Since securitization product trading is basically done between professionals, in some aspects legal regulations do not suit the situation. However, given the current direction of domestic and overseas markets, it is desirable that distributors establish a system that delivers a clear explanation to investors enabling them to make their own risk/return analysis.
- The Financial Services Agency plans to make some minor adjustments to the Guidelines for Financial Instruments Business Supervision to take into account external comments and announce the revised Guidelines shortly.

(4) Current state of disclosure and issues in the securitized product market

A. Securitization of monetary claims

Securitization analyst Tomohiro Miyasaka gave an explanation of the state and issues in the securitization market in Japan (securitization of monetary claims) using the review included as Appendix 7.

The main points of the presentation were as follows.

- Of all the securitized monetary claims on the market, only 30 issues publicly disclosed information on underlying assets. In addition, the 30 issues did not have a unified disclosure format, using different items and definitions. As a result, it is not easy to compare the products.
- While suitable information is provided to primary investors in the securitization market in Japan 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.

Mr. Miyasaka was asked whether the information given about underlying assets in the review included as Appendix 7 was sufficient for investors to make a risk/return analysis. He replied in the following way.

- On its own, the information on underlying assets in Appendix 7 was not enough to make a risk/return analysis. Additionally, it would be necessary to have default rates for the underlying assets, expected cash flow for the securitization product, and reference prices. Only then would the investor be able to calculate the spread and determine whether the product was selling at a discount or premium considering the default rates of the underlying asset.

The WG Chair suggested that ABS analysts of WG member's companies discuss separately what information would be necessary to enable investors to make a risk/return analysis and prepare a working draft to be presented at the third WG meeting. There was no objection to this proposal and it was decided that a working draft would be prepared, mainly by analysts, and announced at the third meeting of the WG.

B. Real estate securitization

Securitization analyst Hidetoshi Ohashi gave an explanation of the state and issues in the securitization market in Japan (real estate securitization) using the review included as Appendix 8.

- In Japan, there is insufficient macro data of the overall market, such as operating rates 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 issues 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 products 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 methods will serve as a good reference.
- In the USA, 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 23rd in 2006.
- Disclosure items and definitions also are not standardized in the J-REIT market in Japan.

(5) Definition and scope of securitized products

The WG Chair explained the definition and scope of the "securitized products" that will be the object of the discussions of the WG using the draft included as Appendix 9.

The WG decided to undertake concrete discussion of the draft at the next meeting.

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