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

1. Date
November 12, 2008 (Wednesday) 15:00 to 17:00

2. Place
JSDA Conference Room

3. Participants
As stated in Appendix 1

4. Agenda
(1) Self-regulatory rules

5. Summary of Proceedings

(1) Self-regulatory rules

(Article A-1)
The Deputy WG Chair expressed the following opinion.
- How about inserting the phrase "based on the goal of enhancing the information provided to the customer, who is an investor"? Although in the self-regulatory rules, investors are called "customers," the purpose here of going to the trouble of using the word "investor" is to clearly state that we are aiming to provide information oriented toward investors. In doing so, we are trying to respond to the indication made in the previous meeting that the expression "when requested by the customer" in Article B-1 "could give the impression that we were not being proactive in providing information."

It was decided to make the following revisions.
- Insert "based on the goal of enhancing the information provided to the customer, who is an investor"
- "securitized products market" → "securitization market"

(Article A-3, (i), and (ii))
It was decided to make the revisions below, respectively.
- (i): "the location and content are clear" → "the products have features that make their location and content clear"
- (ii): "products distributed to holders of underlying assets or to conduits without a decision by customers" → "products distributed to holders of underlying assets or not being distributed to conduits based on a decision by customers

(Article A-3, (iii))
The WG members had the following opinions.
- In the current draft, products in (iii) can be understood as not being covered by the definition of "securitized products" and therefore it seems strange to be setting up a rule to exclude such products from that definition. Wouldn't it be sufficient to make the purpose of the rule clear in the Q&A pamphlet and not set up a separate exclusionary clause? In practical terms, if there are products that look like the products in (iii) even though they are equivalent to "securitized products," they should be included in the Q&A pamphlet as products that are not covered by (iii) and fall under the self-regulatory rules.
- If (iii) really has to remain in the rules, the part about "based on related laws and ordinances" should be revised to "based on related laws and ordinances, etc." The reason for the revision is that with some overseas hedge funds, the reports on portfolio management are not required by

law but based on contractual obligations. As a result, there are products that do ensure traceability and should be able to be excluded from coverage under the self-regulatory rules.

In response, the Deputy WG Chair expressed the opinion below.

- The point here is whether the definition for "securitized products" is perceived to be a question of the "actual nature" or the "form" of the products. The basic thinking in this WG is that these products should not be looked at in terms of "form" but in terms of their "actual nature." How would it be if we restated the definition of "securitized products" as "real liquidity-type products" and expanded the scope to include "in form investment-type products (but actually liquidity-type products)"? (How about inserting "really" before "specified assets"?). Based on these changes, we could keep clause (iii) in order to clarify the purpose of the phrase "actual investment-type products are excluded."

Multiple WG members made the following comments.

- I agree with the Deputy WG Chair. We should expand the definition based on the "actual" argument.
- The Deputy WG Chair's proposal is simple and easy to understand.
- In actual terms, I think both proposals are the same.

The WG decided to make the following revisions.

- "products with obligations based on relevant laws and ordinances"→ "products which have traceability ensures through obligations based on relevant laws and ordinances or contracts, etc."
- A clarification that hedge funds are excluded from the self-regulatory rules will be added to the Q&A.
- In "Paragraph 1": "Specific assets" → "Really specific assets"

(Q&A pamphlet regarding A-3 (iii))

WG members had the following opinions.

- I would like it made clear using the Q&A pamphlet and other means that clause (iii) is not applicable to securitized products that are obtained by a pension fund based on the investment advice of an asset management company, and the self-regulatory rules are applicable to these products.
- I think it is possible that if we interpret (iii) superficially, it could be misunderstood to apply to some investments made in ABS in the bond or notes portion of the portfolio allocation of an asset management company managing the cash of a pension or other fund, resulting in those products being excluded from coverage by the self-regulatory rules. However, in this case, as the fund manager (fund management company under FIEA), the asset management company only receives information on the underlying assets of the ABS as a general investor. Consequently, there is no way that it have more information on the underlying assets than the distributor, as would be the case with a fund manager for the investment-type products set out in (iii). That means, as a product covered by the self-regulatory rules, the distributor is obligated to try and ensure traceability.

The Deputy WG Chair expressed the opinion that the text of (iii) should be revised to prevent such concerns.

The WG Chair made proposal below, which was approved.

- It will be made clear in the Q&A pamphlet that securitized products that are obtained by a pension fund based on the investment advice of an asset management company do not fall under (iii) and are covered by the self-regulatory rules. However, if the Q&A pamphlet is included with the Q&A pamphlet making clear the products to which (iii) applies, there is the danger that it could lead to a misunderstanding that there is an issue with pension funds themselves. Therefore, we will put it in a separate Q&A pamphlet.
- We will reexamine whether it is possible to revise the text of (iii) for the same purpose for the next meeting.

(Article A-3, Paragraph 2)

The WG decided to make these revisions.

- "persons already holding securitized products" → "persons holding securitized products distributed by said JSDA member"

(Core Text of Article B-1)

The WG decided to make these revisions.

- Insert "while continuing to fully consider preserving the traceability of the securitized product" after "the JSDA member"

(Article B-1, Paragraph 1)

The WG decided to make these revisions.

- Insert "Prior to the distribution," at the first of the paragraph
- Delete "while continuing to fully consider preserving the traceability of the securitized product"

(Article B-1, Paragraph 2)

The WG decided to combine this paragraph with Paragraph 1.

(Article B-1, Paragraph 3)

The WG decided to make the following revisions.

- "collecting" → "collecting and analyzing"
- "investor" → "customer"
- "information item → "information"
- "You are cautioned that the information to be communicated includes risk that is not reflected in the credit rating of the securitized product." will be placed at the end of the paragraph.

(Article B-1, Paragraph 4)

The WG decided to combine this paragraph with Paragraph 3.

(Article B-1, Paragraph 5)

The WG decided to make these revisions.

- "Following the distribution" will be inserted at the head of the paragraph.
- "collecting" → "collecting and analyzing"
- "to enable a customer to easily trace the information, distributors will consider communicating to said customer the information items collected on the details and risks of underlying assets, etc. Having done that, the distributors will communicate it except for cannot being communicated to said customer" → "to enable a customer to easily trace the information, distributors will consider the collection of information and collect and analyze information that they decide should be collected except for cannot being collected. Having done that, the information that they have decided should be communicated to the customer shall be communicated to the customer"
- "investor" → "customer"

An observer had the following opinion.

- The rule says "however, this is not limited to … when the information is communicated to said customer by a third party or some other method." In this case, since there is not the object of "communicate", the current text does not make it clear whether the distributor is just allowed to not communicate the information, or whether this extends also to collecting and analyzing the information. For example, with CMBS, for disclosure during the period following the issue the servicer collects and analyzes the information and in many cases trust banks are the ones that communicate the information. If the rule says "distributors that are JSDA members must collect and analyze information" isn't this not very realistic?

In reply, the WG Chair said that the rule is saying that when the information is communicated by a third party or some other method, it is not necessary for the JSDA member to duplicate the collection and analysis of the information.

(Article B-1, paragraphs 3 and 5)

WG members had the comments below about the expression "information decided necessary to communicate"

- Since the basis of the "decision" is not necessarily clear, there is a concern that the sort of misunderstandings pointed out so far could occur. If the meaning is "if the distributor thinks it necessary to communicate the information to the customer," how about an expression such as "information thought necessary to communicate to the customer"? Rather than items decided subjectively by the distributor, I think it would be better to have the nuance of items communicated objectively.
- I think such terminology as "decision" and "examination" is not used very much in other self-regulatory rules. What does the Secretariat think of this?

The Secretariat had the following response.

- We don't know whether or not such terminology as "decision" and "examination" has been used in other self-regulatory rules. However, for the current draft of self-regulatory rules, we did have the department responsible overall for self-regulatory rules at the JSDA check the draft. They did a check for consistency with other self-regulatory rules and terminology, and at this juncture, nothing has been pointed out about the use of such terminology as "decision" and "examination."
- However, the term "decision" does appear twice at the point of collecting information and communicating it. Of the two, "the collecting decision" means "the distributors decide subjectively which type of information to communicate." On the other hand, "the communication decision" is about, for example, "the customer has said information, therefore the distributors don't need to communicate the duplicated information." Since fundamentally the information collected is communicated, this decision probably carries less weight than "the collecting decision." Consequently, for "communicating," we don't necessarily have to use the term "decision," it would be sufficient to use some expression such as the "information thought necessary to communicate to the customer" proposed just now by a WG member.

The WG Chair made the following statement.

- In these self-regulatory rules, our thinking is based on "the distributor deciding subjectively what type of information should be communicated to the investor." The term "decision" carries weight in that sense. On the other hand, using "decision" frequently poses an issue. Therefore, I would ask the Secretariat to reexamine the expressions used in Article B-1, paragraphs 3 and 5 for the next meeting.

(Article B-1, Paragraph 6)

An observer made the following proposal.

- In paragraphs 3 and 5, the rule is saying "information decided necessary to communicate." As I understand it, this is on the same level of information communication as "explanation of the reason for not being able to collect information." Therefore, how about the expression "when it is decided necessary to communicate to the customer."

A WG member made the comment that the term "information that cannot be communicated" had been deleted, but in actual fact there was information that could not be disclosed to investors even if it was disclosed to the arranger by the originator. There was also a question about how to handle information that had been collected but could not be communicated. In response, another WG member gave the opinion that it would be possible to deal with this type of information in an integrated manner by inserting clarification text on "information that cannot be communicated" in the Q&A pamphlet on "information that cannot be collected."

The WG Chair stated that for Paragraph 6, provisionally, he wished to reconsider the text proposed by the observer at the next meeting. With regard to the Q&A pamphlet as well, he wanted to prepare draft revisions based on the indications of WG members for consideration at the next meeting.

(Article B-2)

The WG decided to place this article at the end of Section 2.

(Article B-3)

The WG decided to make the following revisions.

- "acquiring staff, etc." → "establishing an organization, etc."
- "acquiring staff, establishing an organization" → "establishing an organization and acquiring staffs"

The Deputy WG Chair expressed the following opinion on the Q&A pamphlet on the details of "establishing an organization and acquiring staff."

- When JSDA members are arrangers, as Best Practice, how about using "It is desirable that a confirmation system be established by a body other than the one formulating said product."?
- In the case that the JSDA member is not an arranger and only distributing as well, what about "A body with expertise in the field should set up a system to confirm traceability regarding the said arranger and to communicate to customers."?

A WG member asked whether, in the case that the JSDA member is not an arranger and only distributing, if the member had to carry out confirmation of the arrangers of other companies. The WG Chair replied that at this point, if some time had passed since the issue of the product, it was possible that there would be cases whether the JSDA member could not carry out confirmation because the arranger had exited the market or because of reorganization. In such cases, where to store the information also would be an important theme. The WG Chair stated he wished to deal with this issue in the final report, and with regard to "said arranger" in the question asked, he wanted to change the phase to "said arranger, etc."

(Article C-1)

The WG decided to make the following revisions to the Q&A pamphlet.

- Delete "multiple diversified pools"
- "the actual transfer transaction" → "the actual transfer transaction for specific assets"

(Article C-2)

WG members had the following questions.

- The term "agent or intermediary" was put in with the secondary market in mind. Is it correct to think that this is not related to the primary market?
- What is the purpose behind separating the text on "agent or intermediary" and "distribution" and putting them in separate clauses?

The Secretariat made the following replies.

- The terms have not been organized to mean "primary = distribution" and "secondary = agent or intermediary." In the secondary market as well, in the case that the distributor is holding its own position, we are considering this to be "distribution." The case of "agent or intermediary" assumes that the holdings are not the company's own.
- The reason we separated the text on "agent or intermediary" and "distribution" and put them in separate clauses was to treat them in accordance with the Supervision Guidelines.

The same WG member posed the question below.

- Does "agent or intermediary" apply to placement without underwriting or private placements? In other words, in the case of a primary distributor with no proprietary holdings, does Article A-3, Paragraph 3 apply in terms of a "distribution"? Or does Article C-2 apply in terms of an "intermediary"?

The Deputy WG Chair commented as follows.
• It doesn't matter whether the primary distribution was underwritten or not, as a "distribution" Article A-3, Paragraph 3 applies.
• However, there is the question of whether the current draft can be understood in this manner.

Multiple WG members offered these opinions.
• Isn't the distinction here that if intermediary commissions arise, it is "intermediary" and if it is for a proprietary account, it is "distribution"?
• In a broad sense, the treatment of private placements by primary distributors is seen as one type of intermediary behavior, but in the self-regulatory rules, I think these private placements are positioned as "distributions." Furthermore, I think it would be good to clearly indicate how distribution syndicates are treated.
• I think one of the products that Article A-3 does not apply to is "products where the distributor is an overseas financial institution and a JSDA member is the intermediary." In this case, one of the features of the product is that distribution can take place even if the said JSDA member is not involved.
• I think as an explanation of "intermediary" it should be made clear that it does not apply to public offerings, private placements, or secondary distributions and strictly applies to secondary market.

It was decided that the Secretariat would consider the above opinions until the next meeting.

Internal Rules

The Secretariat offered the following explanation of the "Internal Rules" that the self-regulatory rules require firms to establish.
• The "Internal Rules model" is in the process of being created, but to enable the WG to get an idea of what it will be, we have disclosed an intermediate model.
• The Internal Rules required to be set up by the self-regulatory rules refers to rules that each JSDA member is to establish according to its own situation based on the self-regulatory rules. Therefore, the "model" will be close to the self-regulatory rules. In this point, they are the same as other self-regulatory rules.
• If WG members have comments, etc., on the "Internal Rules model," please submit them to the Secretariat.

CMSA IRP

The CMSA gave the following explanation of the revised version of its IRP.
• In the revised version, we have deleted "Overall opinions" and "Opinion note"
• The issues taken up in "Overall opinions" included the accuracy of the information, legal constraints caused by the Private Information Protection Law and other laws, and the constraints caused by confidentiality agreements. However, we have heard from the Secretariat that the WG's thinking on these issues will be covered in the final report. In addition, we have heard that the final report will attest that the IRP is not something that decides a format, but strictly something with decided items.
• Within the "Opinion note," since some types of reports are to be submitted, they have been included in the items.

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