

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

1. Date

April 10, 2008 (Thursday) 15:00 to 17:00

2. Place

JSDA Conference Room

3. Participants

As stated in Appendix 1

4. Agenda

(1) Definition and scope of underlying asset details and risks

- Disclosure formats (BOJ: the secretariat of the Workshop on Securitization, CMSA-Japan)

(2) Definition and scope of securitized products

5. Summary of Proceedings

At the start of the meeting, the WG Chair said that following the previous meeting he had received a variety of opinions from each member company in many forms. Most of the opinions were positive and supportive of the activities of the working group. However, there were also requests that the scope of the disclosure be kept to a minimum or the content be kept as abstract as possible. The task of the WG is to respond in detail to the request by the Financial Services Agency to come up with a system within its Guidelines to ensure the traceability of assets used in securitized products. This is clearly the basic policy of the WG as approved by members at the previous meeting. Therefore, the WG Chair commented that he hoped there would be constructive debate within the framework of that basic policy.

(1) Definition and scope of underlying asset details and risks

A. the model format for information disclosure by the Workshop on Securitization

Based on the presentation included as Appendix 4, Mr. Koguchi of the Bank of Japan explained the model format.

Following the explanation, the WG Chair asked for what reasons the model format was hardly being used at all. Mr. Koguchi answered as follows.

- As pointed out, he recognized that the model format is only being used in an extremely limited number of cases. 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 the model format was not being used. He also thought it possible that the originators or arrangers were too busy creating deals that responded to the needs of these kinds of investors that they found it difficult to always allocate sufficient resources to disclosure. In addition, it may even be that a certain portion of investors individually receive the required disclosure information from the originators or arrangers.
- Nevertheless, the environment surrounding the securitization market has changed since last summer. He thought that discussing these issues once again in this working group would be beneficial for developing a sound securitization market.

The WG Chair had the following comment.

- Annual issuance in the securitization market in Japan was about 10 trillion yen, and the scale of the market in FY2006 surpassed the corporate straight bond market. From the point of view of increased efficiency in risk management, investor demand for the standardization of

information disclosure is growing stronger. In addition, against the backdrop of the recent subprime loan problem, there was a global hue and cry over the necessity of traceability. Still nothing had changed regarding the difficulty that investors are experiencing in investing their funds. This was happening because it had become more difficult to use securitized products that they were planning to invest in. He said it was important to solve this problem and resume the flow of funds.

WG members made the following comments (paraphrased).

- The reason the model format is hardly being used at all is just as Mr. Koguchi says. The securitization market in Japan has been completely a seller's market since about 2003. Even without improving their disclosure, they have been able to sell out their products as soon as they launched them. There is a question as to whether or not some large investors have been affected by not being able to get sufficient information. Whatever the case, the main point for originators is that there has been no economic incentive to disclose information.
- With almost no secondary market, is there no incentive for originators to provide information to investors other than their primary investors?
- There are extremely limited cases where the model format of the Workshop on Securitization has been used, but even in those cases most of the information is provided based on the product description and explanation document or the prospectus. In addition, the investors with the so-called "large voice" are the ones who get the most information. So whatever the format, in reality there are many cases where the provided information matches the level of information that would be provided through the model format.
- Since the information items that investors require are almost completely fixed, shouldn't it be relatively easy to reach an agreement on the actual format? The information presented to investors through the product description and explanation document or the prospectus occurs at the primary distributions point. For the secondary market in particular, the problem is who is going to provide information on asset performance on a continuous basis after the deal has been completed, as well as to whom (the end user is of course the investor), and in what way.
- Looking at it from the position of those producing the model format, one of the reasons that the model format is hardly used at all is probably that it included too many items at the time it was introduced. 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. Using the model format as our point of origin, don't we need to go through the process of determining what information is truly necessary in practical terms?

The WG Chair commented to the effect that the lack of development of a secondary market in Japan results from, with the exception of RMBSs by the Japan Housing Finance Agency, the maturities of Japan's securitized products being shorter than those in the United States and Europe. He said Japan needed to establish a system that will enable the market here to also introduce long-term assets. He also said we should distinguish the matter of information items from internal procedures. In addition; information vendors are fulfilling an important role in overseas markets in the communication process. He proposed that the WG try holding hearings with several information vendors. There was no objection to this proposal, and it was approved unanimously.

B. CMSA-Japan's Investor Reporting Package

CMSA-Japan made a presentation using the document included as Appendix 5.

Following the presentation, the WG Chair had the following comments.

- CMSA-Japan had to deal with differences in the "information wanted" and the "information that can be provided" for four stakeholders (trustees, investors, servicers, and lenders / arrangers), but there are no large gaps.

- In the United States, CMBS play a major role in linking the real estate and financial markets. The outstanding balance of CMBSs is approximately 70 to 80 trillion yen, 1.3 to 1.5 times the size of the REIT market. Behind the large expansion in the market is the introduction of the IRP just explained by CMSA-Japan.
- In Europe as well, as a result of progressive standardization due to the introduction of the IRP by CMSA, there has been active formation of CMBS using cross-border real estate assets.
- In Japan, even though the office space in Tokyo is on a scale double that of New York, the CMBS market is small and it would be difficult to assert that it is growing into a stable market. Financial markets in Japan have not been able to fully utilize the potential the scale of the real estate market offers as a resource. In aiming to expand the CMBS market, the introduction of the IRP would be highly significant. In addition, the expansion of the securitization market would serve as a trump card in efforts to strengthen the competitiveness of our financial markets.

(2) Definition and scope of securitized products

The WG Chair submitted a working draft, included as Appendix 7, on the scope of securitized products that will be the subject of prioritized and focused discussions by the WG. The WG Chair explained that the WG Chair, Deputy Chairs and secretariat had revised the draft submitted at the previous meeting (included as Appendix 9 in the 1st meeting) to reflect the opinions submitted by each of the member firms of the WG.

Next, a Deputy Chair gave the following explanation of the thinking behind the process of including the opinions of WG member firms.

- Looking at the opinions submitted by the working group member firms, he thought there was some confusion between the discussion of what to include or not in the scope of the Guidelines for Financial Instruments Business Supervision (the Guidelines) and in the discussion of what to include or not in the unified information disclosure format.
- For that reason, they had prepared a separate attachment to the document included as Appendix 7. In that attachment, they first demonstrated what was to be included or not in the scope of the Guidelines. Within securitized products, even without putting restrictions on the distributors, there were some products for which there was clearly no problem with traceability. These products had been included within the frame on the right as being outside of the Guidelines. This group comprised those products that have the special product characteristics indicated in points 1 to 4, and as was indicated in the responses to the public comment paper on the Guidelines put out by the FSA, investment trusts and other similar products probably should also be included here.
- The next explanation was on the frame on the left, which showed those products to be included within the scope of the Guidelines. Here it was natural to include all primary and secondary securitized products, as well as debt and equity securitized products. Therefore, if a unified information disclosure format was not introduced and the establishment of internal procedures to provide information on individual transactions and prices was dealt with on an individual voluntary basis, there would not necessarily be any clear standard for 1) what type of information and 2) what type of procedure should be provided.
- Within the frame on the left, the shadowed area included securitized products that would be subject to the unified information disclosure format. He said this is where the commoditized products would be placed. There is a clear standard for the procedures required for these products, and in that sense, the regulations provide a high level of confidence for distributors. In addition, as previously discussed, these systems offer a high degree of convenience to investors.

The non-shadowed area will be subject to the Guidelines, but will include products that will not be subject to a unified information disclosure format, for example secondary securitized

products that have a relatively high hurdle for standardized information. For these products, in lieu of any unified information disclosure format, he thought distributors individually should be required to establish high-level internal procedures.

- By looking at the opinions of WG member firms, he also thought there may have been some confusion in the discussions about determining which information items should be included and which procedures to establish. For the securitized products in the shadowed part, even if a unified information disclosure format was made for them, the WG would have to discuss how individual transactions should be handled in the internal procedures establishment section. In that sense, when going through the process of determining which information items to include, the WG will first have to determine a maximum that supplies the information necessary for risk/return analysis by investors.

Continuing on, the WG Chair made the following two proposals, which were both approved unanimously.

(Proposal 1)

- As was clearly indicated in the responses to the public comment paper of the FSA (April 2), determining the scope of application of the Guidelines has been delegated to the WG and obviously we have to come up with something suitable. Although all secondary securitized products and equity products really should be made subject to a unified information disclosure format, to proceed efficiently with discussions, the WG will instead choose strategically to begin its discussions with the debt forms of primary securitized products (Specifically, RMBS, CMBS, CLO, and ABS). For the products (Secondary and equity type securitized products) left out of the scope of the prioritized and focused discussions, we propose creating a roadmap outlining a schedule for discussion of those products, which would be included in the interim report.

(Proposal 2)

- In discussions about creating a unified information disclosure format, for CMBS we propose starting with the format of CMSA-Japan, which was prepared based on discussions with multiple stakeholders, as our base. For RMBS CLO, and ABS, we propose starting with the model format for information disclosure by the Workshop on Securitization and make the necessary revisions. For this process, we propose establishing a separate Unified Information Disclosure Format Initiative Team, comprising about 10 members including investors, originators, distributors, rating companies, and others. The team will carry out thorough discussions, prepare a working paper, and make a report to the WG in about a month, which will be used for further discussions. Because of the time restraints for setting up this team, he asked that the selection of team members be entrusted to the WG Chair.

Next the WG Chair gave an explanation of the scope of securitized products subject to prioritized and focused discussions in the WG using the draft included as Appendix 7.

WG members had the following comments (paraphrased).

- In the sense that it provides a prioritized scope for producing a unified information disclosure format, the grouping proposed in Appendix 7 is agreeable.
- This may upset the order of prioritization for creating a unified information disclosure format, but the secondary securitized products that have become an issue because of the recent subprime loan problem and securitized products that use foreign assets as their underlying assets should not only be the subject of our discussions, but also be taken into account in the creation of a unified information disclosure format.

The proposal on the scope of securitized products to be included in the prioritized and focused discussions of the WG was approved as stated in Appendix 7.

The WG Chair announced that he was planning to invite a representative of the Japanese Institute of Certified Public Accountants to a future meeting and conduct a hearing regarding the recently announced memo “On Auditing the Evaluation, etc., of Securitized Products.”

(End of document)