

## Minutes of the Sixth Meeting of the Working Group on Distributions of Securitized Products

### 1. Date

June 5, 2008 (Thursday) 15:00 to 17:00

### 2. Place

JSDA Conference Room

### 3. Participants

As stated in Appendix 1

### 4. Agenda

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

### 5. Summary of Proceedings

At the start of the meeting, the WG Chair made the following comments.

(Regarding Item 1)

- Today's meeting is dedicated to continuing discussions from the previous meeting. Based on the opinions expressed by each firm, especially WG members, the WG Chair and Deputy Chairs have revised the appendix documents from two meetings ago, on which we will base today's discussions.

(Regarding Item 2)

- This is also a continuation from last time. There were questions from WG members during the last meeting's discussions on the treatment of theoretical prices under the supervision guidelines and JSDA guidelines, and today an FSA representative will provide an explanation as we proceed with discussions.

(Regarding Item 3)

- For the discussion on the unified information disclosure format, the Unified Information Disclosure Format Initiative Team formed at our third meeting on April 23 have worked tirelessly in proceeding with their discussions. Today we will hear their report and discuss about it. As of today, the Unified Information Disclosure Format Initiative Team will be dissolved and any further discussion on the format will be undertaken by the WG itself based on the working draft they are submitting today. We would like to thank all members of the team most sincerely for their hard work on this project.

(Item 1) Establishing procedures for collecting and reporting on details and risks of underlying assets (Wrap up)

The WG Deputy Chair commented as follows on the main changes made in Appendix 8 of the 4th meeting, included this time as Appendix 4.

## Regarding Condition I

(Overall)

- We divided Appendix 8 of the 4th meeting into products that were covered by the unified information disclosure format and those that were not. We have revised that into a “(1) Basic policy” that acts as a common set of rules for all products whether they are covered by the unified information disclosure format or not.

((1) - Pre-distributions, Point of distributions, Post-distributions)

- In order to provide a clearer message concerning the sentence “information must be recorded” to investors, we changed this to “information must be prepared so that it can be clearly explained.”

((1) - Pre-distributions, Post-distributions)

- For “cannot be done” reasons, we added “if the originator says they cannot disclose, that will be an acceptable reason.”

((1) - Point of distributions, Post-distributions)

- We added “‘Other methods’ include the legal disclosures in case of public offerings”. One of the aims is to give incentive to information disclosure, since there are fewer burdens on the seller if information is disclosed compared to cases where information is not disclosed.

((1) - Pre-distributions)

- To clarify “information items” we inserted “items the distributor deems necessary in order to report information properly” and “items judged necessary to be collected.”
- We inserted “‘analysis’ is not limited to fixed volume analysis, but includes qualitative analysis” in order to give “analysis” a comprehensive definition.

((1) - Point of distributions)

- We inserted “provided, in a case that third parties or other methods will be used to report information to investors, this does not apply” and “securitized products available for distribution” in order to clarify the two.

((1) - Post-distributions)

- Based on the indication that “in post distributions activities, the distributor cannot always determine whether the investor is continuing to hold the securitized product,” we inserted “limited to investors who can be determined to be holding the securitized product”.
- For clarification, we inserted “necessary for investment decisions and determining market value” and “implemented the said request.”

((2))

- In principle, the “(1) Basic policy” applies in all cases. However, when the distributor determines that the use of the unified information disclosure format is appropriate, the distributor may substitute as stated in (2). In other words, in principle the distributor must decide independently based on the outline of the supervision guidelines, as described in (1). But when (2) is applied, the distributor can use the unified information disclosure format as a guideline.

## Regarding Condition II

- With regard to personnel and organization, while it is not appropriate to set down too much detail in the sense that it will constrain the management decisions of individual firms, if nothing is written down the involved firms will not be on the same page. From that point of view, we harmonized the expressions in order to obtain a balance between these two aspects.

- In Appendix 8 of the 4th meeting, we changed “specifically” in the fourth line from the bottom to “for example” in order to clarify that the sentence is only demonstrating an example.
- In Appendix 8 of the 4th meeting, we removed “between originators and distributors,” to soften the expression.
- At the very end, we changed “is necessary” to “is desirable,” to take into consideration that the establishing procedures is a management decision for each individual company.

The following comments were made by WG members.

- Overall, it is difficult to create a concrete image of what this will look like when it is put into practical business.
- There is an information gap between distributors that are arrangers and those that are not. When reflecting these recommendations into self-regulatory rules, that point should be taken fully into consideration.
- You use the word “Public offerings” but it’s necessary to make its meaning a little clearer. For example, do you only mean the legal disclosure requirements given in Financial Instruments and Exchange Act for “public offerings” and “secondary distributors?” While you are not asking for legal disclosure on the level of that for FILP agency bonds, are you including cases where equivalent levels of disclosure will be required?
- In ((1) - Post-distributions) you have inserted “necessary for investment decisions and determining market value,” but it is difficult for a distributor to decide whether it’s necessary or not without a clear standard. For this expression, wouldn’t it be better to revise it to something like “the investor determines that it is necessary for investment decisions and determining market value”?
- Re-checking of the information items in the unified information disclosure format to see if there are any items that are not compatible with legal disclosure items, and necessary adjustments to the format are desirable.
- If products that were issued before the enforcement of self-regulatory rules are to be bound by those rules as well, the issuers’ additional cooperation after issuance will become necessary, which may not always be possible in a practical sense. Therefore, these cases should be treated as a “non-binding target” under JSDA rules.

A representative of the FSA explained, “As I said at the time of the supervision guidelines revision, the FSA is not expecting distributors to make any sudden changes in their operations right from the enforcement date. Moreover, we realize that it is difficult to simply organize products into ‘previously sold products’ and ‘newly sold products.’ As to the issue of whether such grouping should be a non-binding target or not under the JSDA’s self-regulatory rules, it will be determined based on internal procedures at JSDA, so FSA has no particular comments. The desirable process, however, is for the rules to slowly penetrate into the practical tasks.”

Continuing on, the following opinions were expressed by other members.

- The new version of Appendix 4 is extremely well made.
- I have two minor points. First, within “2. Personnel and organization”, there is the term “legal constraint.” I would like to confirm whether in addition to constraints set by the law, this term includes constraints based on confidentiality agreements between operators and principle of faith and trust. Secondly, the term “clear even

from a third party's point of view" is very ambiguous. Since "personnel with expertise", which is another requirement, can make the judgment, the phrase "clear even from a third party's point of view" should be deleted.

After the WG Deputy Chair responded that the phrase should be kept in order to secure objectivity, another WG member gave the following opinion.

- For example, how about using the expression "without a rational reason"? In that case we can give each company responsibility for providing reasoning. On the other hand, the expression "from a third party's point of view" does not clarify who those third parties are, making it difficult to provide evidence.

The WG Chair made a proposal to replace the said term with "without a rational reason", and the proposal was approved without argument.

WG members also had the following opinions.

- In ((1) - Point of distributions), after the phrase "provided, in a case that third parties or other methods have been used to report information to investors, this does not apply", adding "or in the case that the investors can retrieve items on their own" is desirable. By doing this, it will also clarify cases other than proactive communication (cases where the investor retrieves information from operators who are voluntarily disclosing information).
- In ((1) - Point of distributions) there is a section on "liquidity risk, etc." but in the supervision guidelines in addition to "risk of underlying assets" being included in information to be reported, in "Pre-distributions" it says "collecting information on the details and risk of underlying assets." This sounds a little sudden, so a phrase such as "underlying asset risk and" should be inserted after "Distributors..."
- The "etc." in "liquidity risk. etc." is most likely referring to risks other than liquidity risks that will not be reflected in the rating, so should that be explained?
- In ((1) - Point of distributions), in front of the expression "report to investors on their own," should we put an expression like "regarding information items that the distributor has decided are necessary" in order to maintain consistency with "Pre-distributions?"

In response, the WG Deputy Chair gave the following explanation.

- The reasons for breaking up the section on liquidity risk etc. are 1) they were originally broken up this way in the supervision guidelines, and 2) if the details and risks of underlying assets are put together, it may become difficult to use the unified information disclosure format since there are no items in the unified information disclosure format for liquidity risk etc.
- I had no objection to putting "regarding information items that the distributor has decided are necessary" before the expression "report to investors on their own."

Moving on, the WG Chair made the following comments.

- The expression "regarding information items that the distributor has decided are necessary" will be added before the expression "report to investors on their own."
- Regarding the treatment of "etc." in "liquidity risk. etc.," each firm will be asked to give their comments during the process of producing the interim report.

- Since several revisions of the Appendix 4 are needed, it should be done by the next meeting. However, an overall approval from the WG is believed to have been given, and therefore the contents will be reflected in the interim report.

(Item 2) Internal procedures for evaluating, calculating, and reporting theoretical prices(Wrap up)

The WG Chair said that at the previous meeting it was his impression that a consensus had been reached on using the JSDA's guidelines as a base for establishing "Internal procedures for evaluating, calculating, and disclosing theoretical prices." During the discussion there were questions on 1) whether or not it made sense in the discussion of market value information and theoretical prices to split up securitized products from other products and discuss them separately and 2) while they were discussing "theoretical prices" with regard to the supervision guidelines, what is being covered in the JSDA guidelines is "market price." Moreover, it was asked whether it was really correct to substitute theoretical price for market value in the JSDA's guidelines section on "when it is judged to be difficult for association members to make a rational assessment or calculation, the firm is to explain the reasons for that to the counterparty and not provide an assessment or calculation of market price information." He said he would like to confirm those two points.

Carrying on, the WG Chair made the following explanation of the above point 1) "whether or not it made sense in the discussion of market value information and theoretical prices to split up securitized products from other products and discuss them separately."

- The supervision guidelines on which the WG is based is for securitized products, and therefore the scope that the WG should stick to is securitized products. Of course, it's not a problem to include products other than securitized products in the discussions of market value information, but it was not really within the scope of the WG.

An FSA representative had the following comment.

- The supervision guidelines were formulated with the "price evaluation and market price calculations" in the JSDA's guidelines in mind. Of course if you look closely at the "theoretical price" in the supervision guidelines and the "market price" in the JSDA's guidelines, there may be some differences. He said that in that sense, it was perhaps necessary to brush up both the supervision guidelines and the JSDA's guidelines, but at any rate he didn't see any major differences.
- As stated in the public comment responses, the supervision guidelines are asking distributors to establish procedures that are basically like the "price evaluation and market value calculations" in the JSDA's guidelines and to 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.

A WG member said that under the supervision guidelines, "even when it is difficult to determine a specific market price, a theoretical price is to be evaluated and calculated and report to the customer." She was concerned that there existed the risk that while the distributor would disclose the "theoretical price" to the investor, the investor would treat it as a "market price." She asked whether it would be necessary to

confirm with investors on how they were using the disclosed “theoretical price”. A representative of the FSA gave the following answer.

- As pointed out in the public comment responses, no matter what price the distributor report to the investor, it is up to the investor to discuss it with his accountant and take responsibility for the decision. I do not acknowledge that the distributor has any responsibility for the information provided as a service.

The WG Chair said that as a WG we had agreed to move ahead on “establishing an internal procedure for evaluating, calculating, and disclosing theoretical prices” using the JSDA’s guidelines as a base, and he wanted to reflect that in the interim report.

### (Item 3) Unified Information Disclosure Format Working Draft

The WG Chair said, “obviously, the details of the report we are about to hear from the Unified Information Disclosure Format Initiative Team is not the final version, and it is only at the working draft stage. To call it the final version of the Unified Information Disclosure Format would be extremely misleading, so why don’t we call it the ‘Common Information Item List?’” There were no objections to this proposal.

Mr. Egawa, the team leader, then made the following report.

- The initiative team was formerly established during the third meeting of the WG on April 23, and comprised of 11 member companies and 2 observer companies, totaling in 13 companies. 1-3 people from each company participated, resulting in a very large group, and the deliberations begun before Golden Week. Energetic discussions were carried out, as the members did not limit themselves to meetings but communicated back and forth by e-mail as well.
- The initiative team had been instructed by the WG to 1) proceed with discussions on an asset type basis in the four fields of RMBS, narrowly defined ABS, CLO, and CMBS and 2) base their work on the model format for information disclosure by the Workshop on Securitization and the proposed Investor Reporting Package that CMSA Japan is working on. The initiative team had based its discussions on these instructions.

Mr. Egawa gave an explanation of the “Cautionary Notes” of the Common Information Item List following P. 2 to P.4 of Appendix 5- (1).

- Appendix 5- (2) contains the Common Information Item List for RMBS, narrowly defined ABS, and CLO. “Version 007” is the most recent version, and to help follow the path of the discussions “version 006” and “version 005” are also included.
- The footnotes include “matters that have not been included as items but should be considered” or “cautionary notes about items.” Among them, such notes as “when the originator/initial servicer company does not hold the subordinated portion, that indication shall be included” or “it is desirable to include the necessary information on the maximum debt per borrower, Basel II tier 1 information, and information for putting numbers to the rating based approach in the internal ratings-based approach” were not in the model format for information disclosure by the Workshop on Securitization.
- The treatment of narrowly defined ABS and CLO is not very different from that of the model format for information disclosure by the Workshop on Securitization.

Conversely, with RMBS we added the planned payment schedule for housing loans that were underlying assets and the forecast payment schedule.

- For the “Buy back ratio” of RMBS and narrowly defined ABS, we added a supplementary note to the effect that “it is desirable to disclose the breakdowns for each reason.” This refers to the buyback option of the originator, and the reasons for executing the option (if the originator doesn’t buy back is there a high possibility of default or not) are highly significant for credit risk management.
- Regarding CMBS, the preliminary report on standards (proposal) received by the initiative team on May 29 is included as Appendix 5-(2). In addition, the requests made regarding the IRP to the Standardization Subcommittee of CMSA Japan are included as Appendix 5-(3).

The WG Chair asked what they thought of the details of CMSA’s investigations and what the differences were between CMBS and other securitized products from the perspective of the initiative team responsible for creating a Common Information Item List for the three types of securitized products. Mr. Egawa answered as follows.

- The reason for using the IRP of CMSA as is was that the CMSA’s Standardization Subcommittee is composed of members from securities companies, investors, trust banks, rating agencies, servicers, and a wide range of other organizations and people with various connections to Japan’s CMBS market. Therefore, it offers the best representation of market needs.
- Probably the biggest difference between CMBS and other securitized products was whether or not the underlying assets were created with securitization in mind or not. With RMBS, in most cases the assets that are securitized are housing loans issued by financial services institutions without securitization in mind. Because the originator is usually also the servicer, the management of the underlying assets stays within the control of the originator, creating possibilities of constraint on information production due to limits of the originator’s system. On the other hand, in most cases with CMBS, the originator and arranger securities company or other company issues a nonrecourse loan assuming securitization, and uses it as the underlying asset. Therefore the management of underlying assets is entrusted to specialist servicers, making CMBS very different than most RMBS right from the start. For that reason, in terms of information production, CMBS are easier to deal with compared with other asset classes among securitized products. With regard to the Common Information Item List as well, it is possible that compared to the other three asset classes the CMBS list will be different (more information items than the other asset classes, etc.), but because of the greater ease in information production, they shouldn’t be compared on the same level and it is unlikely that the information items for each class can be systematically aligned.

CMSA Japan made the following report on their investigation of adjustments in the IRP for the Japanese market.

- The Standardization Subcommittee of CMSA Japan began its examination of the Japan version IRP at the end of March. Four sub groups were formed (trustee, investor, servicer, lender and arranger), and their findings were discussed in the plenary sessions for putting together a basic proposal.
- There have been four Subcommittee meetings up to this point, and the opinions raised in those discussions have been reflected in the format that was just introduced. A full agreement is close to being reached on the items to be included in the format, and all that remains to be done is to decide on the treatment of items

that will not be included in the actual format content (third party report and detailed property information).

- The IRP proposal schedule at this point is that tomorrow (June 6) is the deadline for collecting opinions from Subcommittee members. Following that, at the Subcommittee meeting on June 16, discussions will be finalized on most of the issues. Completion of the final version should be around June 20.

The WG Chair proposed that before the next meeting on June 24 that the final version of CMSA's IRP be sent to WG members by the Secretariat by e-mail so that at the next meeting they could receive a report from CMSA on it. There was no objection to this proposal.

A WG member asked the representatives of CMSA Japan on how they divided up the information item levels on the IRP. A representative of CMSA Japan gave the following reply.

- Classification of levels is still under study. There is a feeling that almost all the items will end up being "level 1." To achieve a balance with RMBS, she wanted to discuss this point with the initiative team at a later date.
- From the servicer's point of view, it is clear that not every item requested will be provided, but taking into account the importance of the requested item they intended to accommodate as many as possible.

The WG Chair asked "in the report by the initiative team, it was indicated that it would be desirable to formulate information disclosure items and items to be reported to investors within the information disclosure working group of the Securitization Forum of Japan. Couldn't that be used as an alternative to today's proposal?" Team leader Mr. Egawa gave the following response.

- First of all, I did not say that it was desirable to formulate information disclosure items and items to be reported to investors within the information disclosure working group of the Securitization Forum of Japan.
- The Securitization Forum of Japan is a place where originators, arrangers, investors, and various other types of related people and organizations get together voluntarily for an ongoing discussion on securitization of monetary claims. The discussions held there are in context to the actual conditions of the market. For that reason, if the Securitization Forum of Japan was to formulate a format for voluntary use by market participants, and if it was decided that it was acceptable to use that within the JSDA's self regulatory rules, it is supposedly possible to use it as an alternative.
- However, the Securitization Forum of Japan's objective is not about discussing JSDA's self regulatory rules, and it would also be a problem if a portion of the JSDA's self regulatory rules was completely commissioned to a voluntary organization of market-related people.

A WG member expressed the opinion about separating levels of items. She asked whether it is really necessary to separate levels. "If levels ended up being more important than the content it would be a problem. Given the fact that the Common Information Item List needs to be used flexibly in accordance with the special features of products and trading conditions, and that operating methods indicate that 'even if the item is one that is a high degree of importance to the investor, if the distributor



cannot offer the information, it will not be reported', isn't it rather pointless to be going through the trouble of having separate information item levels?"

The WG Chair responded to this question by saying, "even with cases where reporting the information item is difficult, if the degree of importance of the item in the investors risk analysis is extremely high, the distributor will be asked to come up with some kind of a solution. For this reason, dividing items into levels makes some sense. However, at this point in time, even if we give importance to determining different levels for information items, as time goes by it is possible that such classification will no longer fit the situation. In that sense as well it will be essential to revise them. It has been about 10 years since CMSA introduced its levels in the United States. During that time, they have undergone complete revisions five times, an average of once every two years. I would like to see the necessity of continuous revisions of these levels be included in the interim report."

The WG Deputy Chair commented that going forward they would take in the opinions of market participants and formulate an item list and a format, but he had doubts whether these would really represent "best practices" for the market. Many issues were likely to emerge once they started using these tools and it would be necessary to make revisions based on those issues.

Initiative team leader Mr. Egawa said that necessary and helpful information for evaluating the risk of securitized products was on a case-by-case basis. The information item list could not be used on a uniform basis and would have to be continually updated. In addition, no matter how progressive the information disclosure on a product, the list items are not necessarily going to cover all of the gaps. Even if there is something missing on the information item list or a mistake, the product should not be treated as a defective product.

A WG member asked whether in the end the format would be included in the self-regulatory rules. The WG Chair said that that was correct. However, it is not absolutely necessary to use the format if a more effective method existed and it was possible for individual firms to make the decision and be responsible for making a different response. This is indicated clearly in the previously explained "Basic policy." The same WG member gave the opinion that a format with the same large number of items as CMSA's format might be better in an administrative sense, but conversely for simple RMBS, there might be situations where each company would be better to use their own formats if the items matched.

The WG Chair commented that it is important to look at the information items necessary to determine risk from the point of view of investors, originators, other market participants, and the regulatory authorities because they wanted to nurture a securitization market that investors were confident in.

A WG member expressed the opinion that although the initiative team leader had reported that the information items included items that distributors would not necessarily be able to provide, he wondered how such situations were to be dealt with in the context of the procedure being established in Appendix 4 and what approach should be taken in future. The same WG member also said that they had been shown a Common Information Item List today, but did that mean that a unified information

disclosure format was to be created separately? In response, The WG Chair said that today's information item list was a list that reflected the information needed by investors and the opinion of rating agencies. He said that there had not been time to distill it into a unified information disclosure format, and that we should formulate "a format" because people would not understand when it is put to practical use.

The following opinions were expressed by other WG members

- I got the impression that either the Common Information Item List or the unified information disclosure format could be positioned as best practices assembled based on the wisdom of market participants. As a result he felt some discomfort that they were to be used in relation to the formation of self-regulatory rules.
- I wondered how the JSDA was thinking of maintaining the format. For example, if the CMSA's format was used and CMSA later revised it, what would be the timing of the JSDA's revision of their format? Whether or not there was some that necessity of pursuing this matter?

In response the WG Chair explained that regarding the first point, he wanted members to understand that the WG was premised on the creation of self-regulatory rules. However, through deeper discussion of the contents and the method of use of the format, they wanted to make the format as easy to use as possible. For the second point, starting in the fall, when the CMSA produces its final version of the IRP, they expected to review it and would then clarify just what kind of a relationship should be formed with CMSA regarding the operation and maintenance of the format.

Continuing on, the WG Chair said that from the perspective of creating a highly practical format he thought that it was important to receive a broad range of opinions from originators. The Common Information Item List reported on today would be included in the interim report. Therefore, starting in the fall they were thinking of doing a survey regarding the list to find out what originators thought of it.

The WG Secretariat made the following comments.

- At this stage of the scheduled interim report, today's information item list will be included. However it was at a stage where it had not yet been properly examined in terms of practicality. Therefore, beginning in the fall, the WG will examine it in practical terms and convert them into rules.
- We assume that the format in its final version will be placed in the JSDA's rules as a recommended format. In that case, we are not expecting any rules concerning the order of items. Of course, during the process of the format becoming widely used, the eventual fixing of the number of items would make it easier to use in an electronic format. However, we believe that this should be left as a voluntary decision by market participants and whether the format should be included in the self-regulatory rules in a fixed format right down to the order of items is an issue that requires careful consideration.
- If the format is to be included in the rules, we recognize that JSDA will have to maintain it. However we would like to think about just how they would maintain it in specific terms.

The WG Chair explained the schedule for the interim report as follows.

- On Monday, June 16, the working draft of the interim report will be distributed to WG member firms.

- WG members should aim to submit their proposals for revisions of the interim report working draft to the Secretariat by Thursday, June 19.
- The interim report will be discussed in a WG meeting on Tuesday, June 24.

Continuing, the WG Chair explained that the content of the interim report will be items that have been discussed and concluded up to this point and will contain a summary of all the points that have already been announced. It will indicate the direction they were headed in and future issues to be considered.

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