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Securitization Forum of Japan

Hatsumeikaikan 3F 2-9-14 Toranomon,minato-ku,
Tokyo 105-0001 Japan
TEL: +81-3-3580-1156 FAX: +81-3-3580-1157
E-mail: info@sfj.gr.jp URL: http://www.sfj.gr.jp/e/

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Comments on Revisions to the Basel Securitization Framework

Securitization Forum of Japan

I. Introduction

A. The Securitization Forum of Japan welcomes the Basel Committee's initiative and appreciates the opportunity to comment on the proposed Revisions to the Basel Securitization Framework ("the Consultative Document").

B. We would like to present our comments regarding the proposals in the Consultative Document, mainly from the perspective of applicability and adaptability in Japan.

C. In general, we are surprised by some proposals contained in the Consultative Document as they are overly conservative and they do not seem to consider various measures taken by the Japanese authorities regarding origination, distribution and disclosure of securitized products and imposition of regulation in the credit rating industry. Considering such recently introduced regulation, oversight and market practice, which we believe made securitization business in Japan relevant and reliable, including Japan Securities Dealers Association's self-imposed regulation on disclosure in 2008, imposition of regulation of credit rating agencies in 2010 under the Financial Instruments Exchange Law of Japan, requiring investor due diligence by several measures, including revisions of the various "Comprehensive Guidelines

Hatsumeikaikan 3F 2-9-14 Toranomon,minato-ku,
Tokyo 105-0001 Japan
TEL: +81-3-3580-1156 FAX: +81-3-3580-1157
E-mail: info@sfj.gr.jp URL: http://www.sfj.gr.jp/e/

for Supervision" by the FSA in 2008 and introduction of Basel 2.5 in Japan, at the end of 2011, etc., we are strongly concerned about the outcome of the introduction of the proposals. Imposing excessively conservative or costly treatment of securitization exposures in the regulation of the banking industry in Japan may discourage the appropriate motivation to improve and utilize structured products as an effective fund-raising tool. Instead of this excessively conservative treatment, more reasonable guidance under the already implemented local regulations is much more effective, avoiding some new regulatory arbitrage or gaming issues.

D. With regard to the revision, we would like to stress that adequate rule-making to avoid multiple consideration of stress factors is essential. Mere rigid treatment and redundant counting of stress factors―that might foster the emergence of inadequate transaction―would stall even necessary and good quality structured business, which will then harm economic growth as a whole.

E. We believe that the securitization market in Japan, albeit small, has served as an important social utility in the financial intermediation in Japan, including among financial institutions, since early-1990s. In addition, we note that despite the absence of serious issues regarding securitization transactions and the credit rating industry in Japan (including, but not limited to, absence of issues resulting from poorly underwritten residential mortgages, absence of mechanical reliance on one-factor Gaussian Copula models in pricing and assessment of thin tranches in synthetic CDOs, absence of massive downgrades of certain types of securitized products originated in Japan, absence of oligopolistic nature of the credit rating industry, absence of substantial losses incurred by Japanese financial institutions in investments in securitizations), regulation and discipline standards of the securitization and the credit rating industry in Japan have been substantially raised since 2008. It is hard for us to understand why the securitization industry in Japan should be penalized by introduction of excessively conservative capital requirement on banks at this time.

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II. Comments on the hierarchy of approaches (relating to **Question 1, 2, 3, 4**)

A. Between alternative A and alternative B, we prefer alternative A. Although alternative B is, to some extent, practical and can be adopted in our view—in that we could derive the required capital amount for "high quality" exposures nearly identical to that derived through the current RBA approach—, it does not allow the use of risk-sensitive approaches such as Revised Ratings Based Approach (RRBA) or Modified Supervisory Formula Approach (MSFA) to all exposures, which we think is a practical problem.

III. Comments on the hierarchy of approaches (relating to **Question 2**)

A. Aside from the proposed hierarchy in the Consultative Document, we consider it is more appropriate to modify the hierarchy of the alternative A to reflect the applicable priority among approaches that is; top (1st) MSFA, 2nd: RRBA, and then 3rd: Simplified Supervisory Formula Approach (SSFA), followed by 4th: Backstop Concentration Ratio Approach (BCRA) ("modified alternative A"). The rationale is as follows:

B. We recognize that the rating performance of structured finance products in Asia and the Pacific region firmly maintains practical reliability of such credit ratings (see Annex 1) and believe that the RRBA is a better approach than SSFA in that RRBA in the sense that they could be more practically risk-sensitive, while capturing substantial and objective reality in calculating required capital. On the other hand, in calculating risk weights to non-rated exposures where RRBA does not apply, we consider that the SSFA is a convenient and reasonable approach.

C. Based on the above mentioned reasoning, we request that, in substitution for the proposed hierarchy of alternative A in which RRBA and SSFA are of the same rank where the regulating authority could discretionally adopt one of them, the hierarchy should have a ranking order of 1st: RRBA and 2nd: SSFA like modified alternative A mentioned above.

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IV. Comments on the hierarchy of approaches (relating to **Question 4**)

A. The current definition of "senior tranches" in paragraph 613 of the current should be amended to delete item (b)[1] of the paragraph.

B. As we mentioned in III.A, we prefer the modified alternative A which we believe is more reasonable hierarchy than proposed alternative A and alternative B. If alternative B were to apply for some reason, the "high quality" senior tranche under RRBA and MSFA/SSFA should be defined to include a senior tranche that is associated with other *pari passu* tranches which have different scheduled redemption periods or amortization schedules. In summary, The senior tranches should be regarded as "high quality", provided that; (1) the *pari passu* clause clearly sets forth that the senior tranche will be treated equally in redemption ranking with *pari passu* tranches, and (2) the tranche carries the same credit ratings from an External Credit Assessment Institution (ECAI).

V. Comments on multiple ratings from ECAIs (relating to **Question 5**)

A. We request that rating from a single ECAIs should be permitted under certain conditions which include: 1) Short-term rating, 2) Small transaction in terms of issuance amount of not more than JPY 30 billion, EUR 0.3 billion, USD 0.3 billion, and 3) where relevant regulating authorities' permit the use of credit ratings from a single ECAI for other reasons, such as the current status of regulation of the credit rating industry in the relevant jurisdiction, reliability of credit rating performance by the ECAI in question and competitive nature and usage of credit ratings in the relevant jurisdiction.. The background rationale is as follows;

B. First, from the viewpoint of originators, rating fee (both up-front and anniversary fee) is a substantial cost factor that affects their fund-raising efficiency in structured finance, especially in terms of short-term structured products. For example, an upfront rating fee of less than 10 bps for a securitized product that would be

[1] "In a traditional securitization where all tranches above the first-loss piece are rated, the most highly rated position would be treated as a senior tranche. However, when there are several tranches that share the same rating, only the most senior one in the waterfall would be treated as senior."

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redeemed in 3 months would result in an increase of sizable amount of bps p.a. in funding cost for the originator. To avoid this cost inefficiency, most originators, aside from sponsors running sizable ABCP programs, make it a market practice to obtain a credit rating from a single ECAI for their short-term structured products.

C. Secondly, small transactions in terms of issuance amount involve relatively few sophisticated investors in general so that we could safely expect that rating errors (if any) do not have a significantly adverse impact among the market participants.

D. The third reason is that, due to the fact that regulating authorities have different circumstances with regard to 1) historical performance (or, track record) of credit rating in the relevant jurisdiction or market, 2) relevance and reliability of structured product ratings, 3) regulation (or absence thereof) and supervision of the credit rating agencies, 4) existence or absence of cross-border securitization transactions and its volume impact to the market and the banking industry in the relevant jurisdiction, it is more realistic to give each of the regulating authorities discretion so that they can set forth a local rule with regard to whether RRBA approach is applicable in the jurisdiction and how many ECAIs are required in RRBA.

E. And lastly, after the implementation of Basel 2.5, all banks have been required to gather information regarding underlying assets―due diligence requirement for the rating assigned to the exposure in question. This implies that calculating risk weight based on a single rating from a single ECAI does not mean a “mechanistic reliance” on the rating. Although RRBA enables banks to automatically calculate risk weight from the rating assigned, financial institutions are not allowed to utilize the rating mindlessly. For example in Japan, under the “Comprehensive Guidelines for supervision of Major Banks” and the “Inspection manual for deposit-taking institutions”, FSA (Financial Services Agency of Japan), after their revisions in 2008, sets forth statutory guidance to deter against excessively depending on ratings. In considering the required number of ECAI, we should count on these already implemented regulations and other measures by the authorities.

F. In 2011, JSDA (Japan Securities Dealers Association) released an interim report on “Recommendable Uses of Credit Ratings” (See Annex 2), in which no negative

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opinions were presented with regard to the relevance of credit ratings by institutional investors, financial intermediaries, issuers and other market participants who participated in the deliberation. This is our mainstream opinion in Japan that most market participants, including major banks, regard external rating as reliable information for credit evaluation.

VI. Comments on the risk weights calculated under RRBA (relating to **Question 6**)

A. Under the RRBA approach, risk weights calculated pursuant to proposed methodology in the Consultative Document are excessively high, in particular, for highly-rated and/or longer maturity exposures. For example, a AAA-rated senior tranche which matures in one year (M=1) attracts a risk weight of 18.1% while a similar senior tranche with a maturity of 5 years (M=5) would attract 58.0% risk weight; almost 3.2 times that of a one-year tranche and approximately 40% points (58.0%－18.1% = 39.9% points) in difference.

B. This result differs considerably from risk weight calculated under the current internal ratings-based (IRB) approach for corporate exposures. For example, for a AA-rated exposure with probability of default (PD) less than 0.03%, IRB risk weight will be 7.0%. In typical cases, highly creditworthy corporate exposures which matures in one year (M=1) will attract a risk weight of 7%. And an identical exposure except that it matures in five year (M=5) will attract a risk weight of approximately 20%; only almost 2.8 times that of a one-year exposure and approximately 13% points (20%－7% = 13% points) in difference. Another corporate exposures which matures in one year (M=1) with risk weight of 18.1% will typically attract a risk weight of around 46%; only 2.5 times and 28% points (46%－18.1% = 27.9% points) in difference. Based on these typical cases, the above mentioned result from RRBA is too conservative to apply.

C. As the Consultative Document reports, it is relevant to adjust “Too low risk weights for highly-rated securitization exposures” for securitization exposure with inadequate or unclear capital structure. The above example, however, implies that the RRBA

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as being proposed will incur "too high" risk weights for highly-rated, senior securitization exposures.

D. In some cases, the SSFA and the BCRA would result in lower risk weight compared to the RRBA. If a much higher risk weight is to be applied to exposures assessed and rated by external expertise (ie, an ECAI), it might discourage obtaining credit ratings, which should not be beneficial to banks. This approach may cause a problematic situation when financial institutions become positive to upgrade their internal management system for credit evaluation judiciously using external ratings as an independent and objective second opinion. To avoid this disadvantage, exposures should enjoy relatively lowest risk weight under RRBA, then second-lower risk weight under SSFA, and finally highest under BCRA. We will add some related points to this issue in later comments.

VII. Comments on the Maturity adjustment under RRBA (relating to **Question 6**)

A. We believe that Maturity adjustment under RRBA is not necessary; the adjustment is rather harmful in calculating risk weight to securitized exposures. Reasons include that rating agencies usually gauge the required amount of credit enhancement based on the maturity of target tranches as well as tenures of underlying assets. Put differently, the amount of credit enhancement required for longer-term exposures backed by the same type of assets with identical PD will be larger than that of shorter-term exposures. Since M is already accounted for in this way in credit enhancement calculations, it would be double-counting to introduce the M (maturity) factor under RRBA.

VIII. Comments on the parameters used in MSFA (relating to **Question 8**)

A. Among several input parameters to calculate K under MSFA, the maturity (M) parameter has a significant impact to the calculation result. Another add-on parameter of "tau" (τ) which is proposed as 100 instead of the current 1,000, also has an impact to be reconsidered.

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B. To see the sensitivity of the two parameters, assume a hypothetical retail mortgage exposure which has the following credit characteristics: PD = 0.4%, LGD = 60%, asset value correlations (AVC) = 0.179, Kirb = 3.0%, Attachment point = 43.0%, and Detachment point = 100.0%. As the example computation indicates (Table 1), we can conclude that tau and M have a substantial impact to the resulting risk weight; longer maturity will result in higher risk weight.

Table 1

Illustrative Risk Weights for senior tranche under MSFA (without floor)
(Infinitely granular, homogeneous pool, PD=0.4%, LGD=60%, AVC=0.179, Kirb=3.0%, Attachment=43.0%, Detachment=100.0%)

Rw_MSFA_ex.floor	τ				
M	100	300	500	700	1000
1	0.000%	0.000%	0.000%	0.000%	0.000%
2	0.000%	0.000%	0.000%	0.000%	0.000%
3	0.001%	0.000%	0.000%	0.000%	0.000%
4	0.021%	0.007%	0.005%	0.004%	0.004%
5	0.132%	0.063%	0.053%	0.050%	0.047%

C. Another example computation (Table 2) pertains to non-senior tranche with Attachment point = 43.0% and Detachment point = 48.0% respectively. The calculation result also shows that calculated risk weight is much higher.

Table 2

Illustrative Risk Weights for non-senior tranche under MSFA (without floor)
(Infinitely granular, homogeneous pool, PD=0.4%, LGD=60%, AVC=0.179, Kirb=3.0%, Attachment=43.0%, Detachment=48.0%)

Rw_MSFA_ex.floor	τ	non-senior			
M	100	300	500	700	1000
1	0.000%	0.000%	0.000%	0.000%	0.000%
2	0.000%	0.000%	0.000%	0.000%	0.000%
3	0.014%	0.002%	0.001%	0.001%	0.001%
4	0.193%	0.065%	0.050%	0.044%	0.040%
5	1.138%	0.574%	0.490%	0.457%	0.433%

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IX. Comments on the constant term "*p*" in SSFA (relating to **Question 10**)

A. We also note that the constant term "*p*" of 1.5 as proposed, tends to produce substantially conservative risk weight values. We would like to urge the Committee to consider a much lower value for "*p*", or, alternatively, introducing different values of "*p*" based on the nature and characteristics of the underlying pools and the position of the tranche. For example, setting a much lower value, such as 0.5, for "*p*" for the most senior tranche may be reasonable.

B. Our sensitivity check for hypothetical retail exposure shows the value for "p" creates too much stress for these granular pools. Pool size = JPY 10 billion, AAA-rated tranche size = JPY 8.5 billion, Attachment point = 15.0%, Detachment point = 100.0%, M = 1.

Table 3

Sensitivity of Supervisory adjustment factor *p* under SSFA

Rw_SSFA					
p	Ksenior	Knon-senior	KSSFA	Rw_SSFA	a
0.5	1.5%	1.5%	0.005%	0.1%	-53.4
0.6	1.5%	1.5%	0.018%	0.2%	-44.5
0.7	1.5%	1.5%	0.042%	0.5%	-38.2
0.8	1.5%	1.5%	0.082%	1.0%	-33.4
0.9	1.5%	1.5%	0.140%	1.8%	-29.7
1.0	1.5%	1.5%	0.218%	2.7%	-26.7
1.1	1.5%	1.5%	0.315%	3.9%	-24.3
1.2	1.5%	1.5%	0.432%	5.4%	-22.3
1.3	1.5%	1.5%	0.567%	7.1%	-20.5
1.4	1.5%	1.5%	0.720%	9.0%	-19.1
1.5	1.5%	1.5%	0.890%	11.1%	-17.8

X. Comments on the use of SSFA (relating to **Question 11**)

A. Where the underlying pool of the securitization exposure includes cash reserve that can be used as credit enhancement, the cash reserve should be fairly considered. One method is to add a value corresponding to the balance of the cash reserves to the attachment point (A). Another method would be to include the cash reserve in the calculation of the weighted average SA risk weight of the underlying pool. As the

Hatsumeikaikan 3F 2-9-14 Toranomon,minato-ku,
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TEL: +81-3-3580-1156 FAX: +81-3-3580-1157
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latter method would be more burdensome, we would prefer the former method of adding a value corresponding to the cash reserve balance to A.

B. In addition, we note that many asset-backed securities (backed by consumer receivables and diversified corporate receivables) and residential mortgage backed securities enjoy excess spread. Such securitization exposures typically withstand much higher cumulative losses of the underlying pools of receivables than the attachment point (A) would suggest. We would like to urge the Committee to consider the benefit of such excess spread (or, future margin interest) in the composition of the formulae. Although, we understand that determining an appropriate value for the excess spread, which could be calculated in many different way, may not be easy; asset-backed securities and collateralized loan obligations (that are backed by actual loans with relatively high interest income) should not be treated indifferently from typical synthetic CDOs where available credit enhancement level is the same as the position of the attachment point (A).

XI. Comments on the definition of maturity (M) (relating to **Question 16**)

A. For securitization exposures (or tranches) backed by pools of self-liquidating receivables, such as auto loans and residential mortgages payable in installments, the definition of “maturity” (M) as it appears in Paragraph 320 of the current Basel text is not appropriate. We believe this definition should be modified for securitization exposures backed by self-liquidating receivables. In Japan, auto loan receivables are typically payable in 48 monthly installments and home loans in 360 (30 years) to 420 (35 years) monthly installments. If an obligor fails to make one or two monthly payment(s), such receivables are considered to be delinquent. Most private-sector RMBS originated in Japan employ sequential-pay structures. Under that structure, principal collections from the entire pool of underlying mortgages are first applied to the principal redemption of the most senior tranche. Once the most senior tranche is redeemed in full, principal collections are then applied to the second most senior tranche. Consequently, the senior tranches in RMBS tend to be fully redeemed in a much shorter period (for example, 2 to 4 years) than the underlying pools of mortgages (e.g., 30 years). An established market practice for pricing and

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evaluating RMBS tranches is using expected WAL (weighted average life) of the tranches in question, which are based on a consensus prepayment speed or a pricing speed (as expressed in CPR, or constant prepayment rates) and default rate (expressed in CDR, or constant default rates). The pricing speed is the CPR value as agreed between the underwriter and the potential investors and is typically a conservative estimate or projection of the CPR in question. Partly because of such market practices, the most senior tranche in an RMBS transaction backed by a pool of 30-year or 35-year fully amortizing mortgages, is considered and evaluated as securities having a 2-year expected average life, for example. In other words, they behave much like 2-year bonds rather than 30-year bonds even though such tranches may have a legal final maturity of 35 years after its issue date. For the purpose of determining the "maturity" (M) of such RMBS tranches, mimicking such market practices may not be appropriate. In order to produce a more conservative value, we would like to propose using a WAL based on zero CPR (or, scheduled monthly collections from the underlying pool assuming no prepayments would occur) as the value of M. Note that typically WALs are calculated based on principal only (interest payments are not considered in such calculation). Only WALs based on principal flows should be somewhat larger than the maturity as weighted average period to payment dates of principal, interest and fees, as interest payments are inevitably front-heavy compared to principal payments. The Committee should allow calculating the WAL without regard to interest payments. For securitization exposures backed by non-self-liquidating assets, we have no objection to the Committee's proposal.

XII. Comments on the floors on risk weights (relating to **Questions 17 and 18**)

A. The risk weight floor for MSFA should be set at 7%, rather than 20%. We believe that the risk weight floors under various types of exposures (including securitization exposures, where the MSFA can be applied) within the IRB framework should maintain consistency. Especially, as the MSFA can be used only by IRB banks where detailed characteristics of the underlying exposures are available, it should not be treated any differently from other types of exposures within the IRB framework where capital requirement is calculated based on the bank's detailed assessment.

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Within the current IRB framework, the effective risk weight (equivalent) floors for all categories of exposures, including securitization exposures, is set at 7% (or, capital requirement of 0.56%). Securitization exposures alone should not be treated differently. If this proposal is intended to address the model risk (or, to create margin of error), we note that (1) similar model risk is inherent in other types of exposures, and (2) by introduction of Basel 3, banks' capital requirement has been substantially strengthened—which should provide additional "margin of error".

B. Setting the risk weight floor for the MSFA at a lower level (such as 7%) compared to other approaches, especially, the SSFA and the BCRA, should work as an incentive for banks to enhance their risk management practice so that the MSFA could be applied. In order to mitigate the risk of errors by the ECAIs' credit ratings, setting the risk weight floor for RRBA higher than that for the MSFA is reasonable, in our view. That said, we note that RRBA is substantially superior to the SSFA and the BCRA, as the ECAIs' credit ratings enjoy the benefit of expert assessment of credit risk and should be considered as an approach that would produce more reliable credit risk measurement than the SSFA or the BCRA.

C. Lower risk weight floors for securitization exposures having shorter maturities may be appropriate. We urge the Committee to consider introducing risk weight floors lower than 20% for exposures with shorter maturities (for example, one year or shorter) for all approaches; given that there is no default case observed among securitization exposures in those shorter maturities, applying risk weight of 20% lacks reasonableness.

XIII. Comments on the proposed risk weight caps, floors and the relationship between the cap and the floor (relating to **Question 19**)

A. Without any hesitation, we fully agree with and support the Committee's proposal. The proposed risk weight caps, floors and the relationship between the two are all logical and reasonable. Such provisions should be introduced in the treatment of the securitization exposures as soon as possible. The current treatment of the securitization exposures for the SA banks practically prohibit securitizing residential

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mortgages and SME loans originated by regional banks in Japan most of which adopt the SA model. Note that many regional banks in Japan were active originators and securitizers of residential mortgages and loans to regional businesses in 2006 and prior years, before the introduction of Basel 2 in Japan. Such unreasonable burdens should be removed (the 1250% risk weight for the retained position without any cap, which would result in a risk asset value of substantially larger than that of the entire securitized assets) from the SA banks immediately.

XIV. Comments on the separate treatment of securitizations backed by retail and diversified assets (relating to **Question 22**)

A. For securitizations backed by retail exposures and diversified pools (such as thousands of equipment lease receivables), different approaches for MSFA, RRBA and SSFA should be introduced in order to reflect relatively stable performance and diversification. Applying a haircut to asset value correlation (AVC) to such securitizations could be one approach. Additional complexity should not be considered as an issue. Treating a broad range of securitized asset pools indifferently and assuming they are pools of corporate credits could produce unintended consequences of penalizing securitizations backed by retail and other diversified exposures.

XV. Comments on the addressing concerns over retail exposures having high default risk or high concentration (relating to **Question 23**)

A. Typically, consumer receivables that experience relatively high default rates (such as credit card receivables, annualized charge-off rates typically range between 3% and 7%) enjoy abundant excess spread, as yield on such receivables are relatively high. Most of the concerns over such (foreseeable) high default rates are already addressed by high yields of such receivable pools. Recent experience over residential mortgages originated in certain parts of the world (not Japan or any other part of Asia-Pacific) is being addressed by imposing regulations on mortgage brokers, strengthening mortgage underwriting standards and requiring credit rating agencies to conduct due diligence. Subsequent performance of poorly underwritten

Hatsumeikaikan 3F 2-9-14 Toranomon,minato-ku,
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residential mortgages in the booming housing price environment in certain parts of the world (not Japan or any other parts of Asia-Pacific) between 2004 and 2007 might be considered as materialization of fraud risk or moral hazard rather than systematic risk or high concentration. Since regulations has been properly addressed this issue at this moment, there is no further conservative treatment required in this regard.

XVI. Comments on calibration among different approaches, especially, among MSFA, RRBA and SSFA (relating to **Question 24**)

A. We believe that in calibration between MSFA and RRBA, a lower PD (such as 1.216%, equivalent to a credit rating of BB) should be assumed. We understand that RRBA, as proposed, has been calibrated against the MSFA based on the assumption that the underlying exposures attract 4.73% PD and 60% LGD (given that the tranche in question is rated BB or higher). The assumed PD level of 4.73% is substantially higher than those seen in typical securitized assets in Japan. Annualized default rates of residential mortgage loans are typically below 1% and consumer vehicle loans (auto loans) typically experience default rates of between 1% and 2%. According to a report published by Ratings and Investment Information, Inc. (R&I), one of the major credit rating agencies in Japan and an ECAI as designated by the FSA of Japan and banking regulators of some other countries, the average default rates observed in 513 auto loan pools between August 2011 and July 2012 was 0.9%. Given the actual default rates of receivables being securitized in Japan, calibration between MSFA and RRBA based on a PD of 1.216% (assuming a credit rating equivalent to BB, rather than B) may be more reasonable.

End of document.

Hatsumeikaikan 3F 2-9-14 Toranomon,minato-ku,
Tokyo 105-0001 Japan
TEL: +81-3-3580-1156 FAX: +81-3-3580-1157
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Annex 1

Cumulative Impairment Rates of Structured Finance Securities

Global Structured Finance

	1	2	3	4	5	6	7	8	9	10
Aaa	0.72%	2.47%	5.58%	8.61%	10.46%	11.23%	11.57%	11.88%	12.22%	12.60%
Aa	4.32%	13.60%	21.07%	26.12%	29.94%	32.38%	34.16%	35.50%	36.85%	38.38%
A	5.18%	14.79%	23.00%	29.64%	35.85%	41.70%	46.89%	50.02%	51.98%	53.31%
Baa	9.57%	21.43%	31.76%	40.17%	47.19%	53.64%	59.32%	62.48%	64.12%	65.50%
Ba	16.53%	28.47%	37.57%	44.53%	49.80%	54.55%	59.02%	62.84%	66.23%	68.98%
B	25.05%	36.42%	45.65%	54.09%	61.47%	67.92%	73.68%	78.51%	82.35%	85.48%
Caa	33.22%	56.31%	66.45%	74.91%	81.01%	84.66%	87.02%	89.13%	91.36%	93.23%
Investment-Grade	3.17%	8.68%	14.22%	18.88%	22.56%	25.47%	28.01%	29.67%	30.81%	31.82%
Speculative-Grade	23.89%	37.75%	46.47%	53.41%	59.01%	63.95%	68.50%	72.41%	75.77%	78.55%
All	6.38%	12.97%	18.77%	23.56%	27.40%	30.54%	33.37%	35.40%	36.95%	38.29%

EMEA ABS, CMBS, & RMBS

	1	2	3	4	5	6	7	8	9	10
Aaa	0.00%	0.00%	0.00%	0.02%	0.05%	0.05%	0.05%	0.05%	0.05%	0.05%
Aa	0.02%	0.07%	0.41%	0.75%	1.04%	1.24%	1.56%	2.15%	3.08%	3.60%
A	0.07%	0.45%	0.97%	1.44%	1.74%	2.06%	2.39%	3.02%	3.46%	3.80%
Baa	0.55%	1.67%	2.86%	3.83%	4.59%	5.22%	5.96%	7.17%	8.85%	8.85%
Ba	2.32%	5.43%	9.12%	12.29%	15.72%	18.71%	21.40%	24.38%	29.34%	29.34%
B	8.55%	16.36%	23.47%	31.41%	34.83%	42.34%	52.69%	52.69%		
Caa	19.16%	40.91%	57.68%	64.22%	68.30%	68.79%	68.79%			
Investment-Grade	0.12%	0.41%	0.80%	1.14%	1.41%	1.64%	1.90%	2.34%	2.81%	2.99%
Speculative-Grade	6.49%	12.96%	18.30%	22.26%	25.64%	28.52%	31.29%	33.81%	38.11%	38.11%
All	0.64%	1.39%	2.11%	2.67%	3.12%	3.48%	3.84%	4.33%	4.87%	5.04%

Asia-Pacific ABS, CMBS, & RMBS

	1	2	3	4	5	6	7	8	9	10
Aaa	0.00%	0.00%	0.03%	0.04%	0.04%	0.04%	0.04%	0.04%	0.04%	0.04%
Aa	0.00%	0.00%	0.08%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
A	0.02%	0.44%	0.76%	1.09%	1.09%	1.09%	1.09%	1.09%	1.09%	1.09%
Baa	0.28%	1.54%	3.18%	5.54%	6.01%	6.01%	6.01%	6.01%	6.01%	6.01%
Ba	1.37%	4.42%	7.67%	13.01%	16.46%	16.46%	16.46%	16.46%	16.46%	
B	6.54%	14.67%	24.07%	38.16%	42.25%	42.25%				
Caa	26.51%	57.87%	81.66%	81.66%						
Investment-Grade	0.03%	0.19%	0.41%	0.69%	0.74%	0.74%	0.74%	0.74%	0.74%	0.74%
Speculative-Grade	5.78%	11.52%	16.20%	22.87%	26.26%	26.26%	26.26%	26.26%	26.26%	
All	0.36%	0.83%	1.28%	1.85%	2.02%	2.02%	2.02%	2.02%	2.02%	2.02%

Note: Impairments include downgrading to Ca or below (Ca or C) and defaults.
Source: Moody's Investors Service, *Default & Loss Rtes of Structured Finance Securities: 1993-2011,* November 16, 2012.

http://www.moodys.com/research/Default-Loss-Rates-of-Structured-Finance-Securities-1993-2011--PBC_147245

http://www.moodys.com/research/Default-Loss-Rates-of-Structured-Finance-Securities-1993-2011-Excel--PBC_147478

SFJ

Securitization Forum of Japan

Hatsumeikaikan 3F 2-9-14 Toranomon,minato-ku,
Tokyo 105-0001 Japan
TEL: +81-3-3580-1156 FAX: +81-3-3580-1157
E-mail: info@sfj.gr.jp URL: http://www.sfj.gr.jp/e/

Annex 2

Japanese Working Group on Recommendable Use of Credit Ratings (excerpt)

"Most WG members recognize the effectiveness of credit ratings, for both corporate finance ratings and structured finance ratings. The effectiveness of corporate finance credit ratings is recognized for the following reasons: (i) they constitute part of the information for market evaluations by issuers; (ii) they are needed as part of the information to make investment decisions; (iii) they are part of the indicators needed for risk analysis; and (iv) they serve as part of the criteria to judge the adequacy of financial instruments to be sold in the market. The effectiveness of structured finance credit ratings is recognized for the following reasons: (i) they are common indicators for investment decisions and helpful to make a comparative review of multiple products; (ii) they serve as reference cases to establish the investment standards because their analysis methods, etc. have been made known to market players; and (iii) efforts to make up such products that fit in for the credit rating methods have been promoting the standardization of structured finance products."

Source: Japan Securities Dealers Association, *Working Group on Recommendable Use of Credit Ratings—Interim Report, 27 June 2011*

http://www.jsda.or.jp/katsudou/kaigi/jisyukisei/gijigaiyou/saikenwg05.html

SFJ

Securitization Forum of Japan

Hatsumeikaikan 3F 2-9-14 Toranomon,minato-ku,
Tokyo 105-0001 Japan
TEL: +81-3-3580-1156 FAX: +81-3-3580-1157
E-mail: info@sfj.gr.jp URL: http://www.sfj.gr.jp/e/

Annex 3

Performance overview: Japanese auto loan ABS (free translation)

The credit performance of underlying auto loan receivables (from January 2003 to July 2012, outstanding amount of the composite is JPY 526.6 billion, consisting of 531 pools originated by 7 auto loan lenders) indicates that the charge-off ratio is 0.9% p.a., significantly improved by 0.5% points down from performance half a year ago (1.4% p.a.). Direct factor that improved the performance was the elimination of temporary deterioration of performance caused by the Great East Japan Earthquake (11 March 2011); the observation horizon this time is August 2011 to July 2012, excluding deteriorated horizon of April 2011 to July 2011. Aside from the temporary deterioration due to the Earthquake, the charge-off ratio consistently continues to drop from its peak in December 2007.

Source: Rating and Investment Information, Inc. (ECAI), "Performance on Auto loan receivables: January 2003-July 2012"
http://www.r-i.co.jp/eng/index.html