



Comments on Second Working Paper on Securitization

1. R&I's achievement in securitization product ratings

- From its standpoint as a rating institution, Rating and Investment Information, Inc. (R&I) has continued to take part in the securitization market in Japan since full-fledged development of that market began in 1996. Initially, lease receivables and auto loan securitization accounted for the largest share of the market. Recent years, however, have witnessed an increase in the types of assets available for securitization, and today more diverse assets, including commercial mortgage backed securities (CMBS) and residential mortgage backed securities (RMBS) in addition to collateralized loan obligations (CLO) and collateralized bond obligations (CBO), are being supplied to the securitization market. As a result of this development, securitization products rated by R&I in 2001 reached an issue amount of nearly ¥1.0 trillion for publicly offered securities (not including ABCP programs), and climbed to an issue amount of approximately ¥1.9 trillion on a basis that includes private offerings. For 2002, R&I expects the amount of securitization issues rated by R&I, on a basis that includes private offerings, to climb to an issue amount of approximately ¥2.8 trillion.

2. Securitization product rating transition matrices

- Because it has accumulated substantial rating transition with securitization products, R&I plans to publicly announce verification of its default rates and rating transition matrices for securitization products next June (in addition to our structured finance rating methodology releases and default rates and rating transition matrices for corporate bonds that R&I announces each year), as these pertain to the disclosure practice for securitization products that an external credit assessment institution (ECAI) must satisfy as proposed in the Disclosure section of Paragraph 53 of QIS3. R&I believes that by releasing this information, it will satisfy the eligibility requirement for ECAI as set forth in QIS3 Paragraph 53.
- In this regard, among the issues it has rated based on the senior-subordinated structure of the credit pools, R&I has downgraded only 11 tranches to-date (as of the end of November 2002). None of these securities has defaulted. Moreover, of the issues R&I has downgraded, all of the tranches that have reached their maturities have been redeemed in full. Although R&I cannot statistically verify its results because it has not yet accumulated sufficient rating performance, we believe this result demonstrates the reliability of R&I's ratings to be sufficiently high.
- Since it began rating securitization products, R&I has rated numerous synthetic CDO. Specifically, during 2002 R&I rated 16 synthetic CDO issues, with a total issue amount of over ¥120.0 billion (total reference credit pool, including the super-senior portion outside the scope of the rating, of approximately ¥1.8 trillion

on a notional principal amount basis).

3. Comments on Second Working Paper on Securitization Annex 3 that refers to QIS3

- In order for banks to achieve a risk-based capital relief effect under the new BIS, pursuant to Paragraph 505(a) of QIS3 all synthetic securitization transactions using credit derivatives must satisfy credit risk mitigation requirements as credit derivatives. Furthermore, pursuant to QIS3 Paragraph 156(a), for a credit derivative contract to be recognized the credit events must cover, at a minimum, “restructuring” as an operational requirement in order for the credit derivative to achieve a capital relief effect under the new BIS.
- When “restructuring” is stipulated as an operational requirement, however, there is a substantial probability that this will create a moral hazard at the protection-buying bank. It is possible to envision that this moral hazard risk will decrease the number of investors for synthetic securitization products, and consequently may impair development of the credit derivatives market in Japan.
- Should such a situation develop, it will be impossible to anticipate growth of synthetic securitization products. The result would lead to greater difficulties in dispersing the credit risk that are currently overconcentrated in the major banks in Japan to other economic entities,. This would undoubtedly become a negative factor for the development of financial and capital markets in Japan, and hence this impact should not be disregarded.
- With regard to the proposal to include “restructuring” among the necessary conditions for credit risk mitigation, we look forward to see that the Basel Committee will reexamine this issue based on the opinion of individuals related to the market and accepted market practices.