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Comment on the IOSCO Consultation Report on the Principles for Ongoing Disclosure for Asset-Backed Securities

Securitization Forum of Japan

I. Introduction

A. The Securitization industry in Japan welcomes this IOSCO initiative and appreciates the opportunity being provided for comment in the consultation process as to the Principles for Ongoing Disclosure for Asset-Backed Securities ("the Principles").

B. Our comments on the IOSCO Consultation Report on the ABS Ongoing Disclosure Principles ("the Report") are based on the existing disclosure practices in Japan's ABS market. Since we basically agree with the observations, purposes, and disclosure topics stated in the Report, we would like to present our comments mainly on the applicability and adaptability of the disclosure topics in Japan.

C. In Japan, there are already several related regulations with regard to ABS ongoing disclosure principles, some of which are summarized in the IOSCO Subprime Report[1]. These practices include: (a) the Financial Instruments and Exchange Act (Act No. 25 of 1948, "FIEA"); its lower-level regulations such as (b) the Cabinet Office Ordinance for Disclosure of Specific Securities (Regulation No. 22 of 1993, "Ordinance"); and (c) the FSA's (The Financial Services Agency) Guidelines for Financial Instruments Business Supervision.

D. In addition, there is voluntary self-regulation of disclosure ("SIRP")[2] in Japan, which was arranged by the JSDA (Japan Securities Dealers Association), and it has been effective since June 2009[3]. The SIRP was originally intended to ensure the traceability of securitized products, by which investors could evaluate the

[1] The *Final Report of the Task Force on the Subprime Crisis*, dated May 2008 ("the Subprime Report"), Appendix A, p. vii.

[2] In 2008, major market participants in Japan discussed the data integrity in Japan's securitization market and established the Standardized Information Reporting Package ("SIRP") to be used for industry-level self-regulation.

[3] The SIRP has recently been restated to ensure better cross reference between the SIRP and the Ordinance and just launched in 1 April 2012.

credit risk of the products using sufficient and up-to-date information of the underlying asset in a timely manner.

E. Now that most Japanese securitized products are regulated under these practices in terms of disclosure, we would like to comment on the Principles from the viewpoint of these existing practices.

II. General Comments

A. Since the subprime crisis, each jurisdiction has made an effort to establish a new supervisory framework to avoid such crisis. These efforts usually relate to disclosure procedures in some way. In fact, we already have several types of disclosure practices for various purposes; not only does the FIEA provide disclosure procedures from the viewpoint of investor protection, but also banking regulations provide rating-related disclosure requirements under Basel II local regulations. In addition, as mentioned before, JSDA has been operating SIRP. Therefore, upon adapting the Principles to the Japanese market, it may be necessary to re-organize all the disclosure-related rules in order not to place the Principles in a crowded field of similar rules, thereby avoiding duplicate disclosure obligations and establishing best practice.

B. We believe the Principles will be effectively utilized as a guideline for ongoing disclosure practices in each jurisdiction. We need to keep in mind, however, that we should always consider who should be liable for the cost associated with the disclosure. If we always place the burden of considerable cost on the sponsor, the sponsor will eventually adopt a fund-raising tool on a private placement basis rather than on a public offering basis to avoid such costs. The FIEA judiciously requires a less strict disclosure level in a private placement with limited investors. As such, jurisdictions should well consider the cost allocation issue prior to applying and adapting the Principles to the Japanese market.

C. In order to avoid spoiling the convenience and efficiency of securitized products as fund-raising tools, we should consider how we could reduce the clerical burden of disclosure under the Principles. If we disregard this aspect and fail to reduce the burden, sponsors will tend to seek alternatives other than securitization so that they could easily raise money with less of a disclosure burden. In this context, it is worth considering placing the disclosure at the discretion of the sponsor, with data references by which investors can easily contact relevant parties for more detailed information or supplementary materials, depending on their needs. Saving both excessive paper work and documentation involved in disclosure will help develop the convenience of securitized products as fund-raising tools on a public offering basis.

D. With regard to the benefit of disclosure, we have concerns about the inconsistent relationship between the positive stance in disclosure and price mechanism efficacy in the market. Sponsors with well disclosed information naturally expect that they can raise money at a lower cost (i.e., low interest or spread) than they

would with less disclosure. However, the reality of the market often shows that investors and other market participants pay attention only to the negative factors of the disclosed information (e.g., high default rate of the underlying asset), and disregard the existence of credit enhancements appropriately addressed in the securitized transaction according to such negative factors. We therefore think that it is important that, in the course of ongoing developing disclosure best practice, we should promote among market participants how to best interpret and utilize the disclosed information in their investment monitoring.

E. The reliability of disclosed information is also an important factor. All information here are meaningful only when ABS is structured in compliance with fundamental premises such as the law of large numbers, sufficient diversification in terms of underlying asset pool and ongoing representations and warranties from the transaction parties. If the pool holds some kind of idiosyncratic feature due to the lack of diversification or misapplication of asset selection criteria, disclosed information such as PDs (probability of default), delinquency rates, the amount of credit enhancement are all less meaningful. From this point, we suppose it is also important to develop the ongoing disclosure rule, considering the reliability of the disclosure under aforementioned fundamental premises.

III. Comments on Chapter 1 - INTRODUCTION

A. In this regard, the Report states that securities regulators may look to the implementation of other initiatives within their jurisdictions. This is an appropriate opinion to effectively launch the regulation.

B. Given the interrelation of global capital markets, we suppose coordination of ongoing disclosure principles is relevant for both investor protection and comparability among markets. Standardization of the reporting format, terms used in the report and definition of the terms may be desirable. However, based on the situation that each market in different jurisdiction differs in market features and local regulations, recommending a practice to put a clear-cut remark, as appropriate, may be more effective.

C. While investor due diligence is a key activity to understand the creditworthiness of the instruments, we suppose it is not appropriate to overly depend on it. This is because there are many other types of financial instruments in the market ranging from near risk-free instruments such as government bonds to stylized instruments like REITs in which asset managers or trustees manage the structure. In these cases, investors sometimes need not in-depth due diligence; they can judge the creditworthiness based on the information provided by these asset managers or trustees. If we should have a stance that investors should have relatively heavy burden to review the scheme by themselves referring information based on the Principles, investors would tend to suppose that investing in ABS would more burdensome than investing in other types of financial instruments.

D. We believe it could also be recommended that the Principles be used as a reference list of disclosure items and topics, a list which enables investors to compare the specific items. This "reference list" method is also desirable based on the fact that the needs and the depth of information required for investors varies depending upon the degree of sophistication in investment decision-making by investors. In this regard, one of the primary purposes of the Principle may be to facilitate investment decisions and investor due diligence[4]. Considering this, there may be an area where it is more reasonable to disclose the minimum items on the reference list while having further information available according to respective investors' individual needs.

IV. Comments on Chapter 3 – Glossary of Defined Terms

A. The definition of "Asset-backed Securities" seems to need more clarification. Some transaction lawyers have expressed concerns that this definition makes it difficult to distinguish typical ABS from other securitized products. For example, CMBS could be regarded as securities that are primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, since the funds to redeem the CMBS usually come from the collection of non-recourse loans backed by commercial mortgages. To rule out such CMBS from the scope of the definition, we should clarify the intended ABS as those backed by a pool of granular receivables or other financial assets, ruling out deals backed by idiosyncratic assets like typical CMBS.

V. General Comments on Chapter 4 – Principles for Ongoing Disclosure for Asset-Backed Securities

A. All these principles described here are good guideline to be referred to when we consider localized regulation as to the disclosure.

B. In addition to the Principles stated in the Report, it may be a good practice to indicate how each disclosure item relates to investor protection mechanism built in the ABS. For example, investors judge the creditworthiness and the benefit from investing in the financial instruments using several checkpoints. These checkpoints include representations and warranties clauses, early amortization triggers and other performance triggers (collectively referred to as "Investor Beneficial Provisions"). Because investors make ongoing investment decision mainly based on the assumption that such Investor Beneficial Provisions would function well during the course of investment. Therefore, we suppose that all ongoing disclosure should be disclosed so that investors could ensure such assumption at the time of ongoing disclosure. Any material adverse events should be not only clearly disclosed in event-based timely manner but also clearly pertain to these Investor Beneficial Provisions as well.

[4] The Subprime Report, p. 1.

C. When we talk about performance, in particular, PDs, it is vital that the disclosure should provide investors with data based on which the expected PD of the ABS was estimated. Our experience of the Subprime Crisis tells us that one of the backgrounds of the crisis lies in the fact that there is little historical data reliable enough to estimate the accurate base case PD for the subprime asset pools. It is therefore important that investors should always know how the applied PD was derived based on what kind of historical data and its limitation.

VI. Comments on b) of Chapter 4 – Financial Information about Significant Obligors

A. As mentioned before, all disclosed information are meaningful only when ABS is structured in compliance with fundamental premises such as the law of large numbers in terms of underlying asset pool, sufficient diversification and ongoing representations and warranties from the transaction parties. From this point, information about significant obligors is one of key factors. We therefore suppose that such information as stated in the item b) is useful when investors examine the ongoing creditworthiness of the ABS.

VII. Comments on j) of Chapter 4 – Event-Based Reporting

A. As is pointed out in the Subprime Report, the importance of disclosure information about asset pool characteristics, in particular, credit-granting or underwriting criteria has been increasing along with the subprime crisis, where a dramatic weakening of underwriting standards triggered the turmoil[5]. We totally agree with the opinions and recommendations stated in item vi). of j) Event-Based Reporting (p.25). In this respect, however, it is essential to discuss further not only how to ensure the timeliness of the disclosure, but also how to warrant the accuracy of the disclosure. Representations and warranties regarding the accuracy of underwriting criteria are also essential, and basically worth disclosing. On the other hand, there is another concern about credit-granting or underwriting criteria disclosure. Some market participants point out negative aspects of such disclosure. Their claims include: (a) in some cases, information about credit-granting or underwriting criteria may not be indispensable to ongoing investment decisions; and (b) there may be a case where investors would excessively rely on the information, resulting in a distortion of their ongoing investment decision. In addition, based on the competitive situation among originators in the same industry, they would tend to strategically avoid disclosing such information. Due to these aspects, it is advisable to further consider in what way and to what degree the information should be disclosed.

[5] The Subprime Report, p. 3.

VIII. Comments on f) Affiliations and certain relationship and related transactions and g) Assessment of Compliance with Applicable Servicing Criteria

A. This section analyses important aspects with regard to affiliations and Servicing criteria compliance etc.. From the viewpoint of ongoing monitoring, it may be a room to disclose these items in a more simplified manner. In the course of investment, investors have strong needs for information associated with Investor Beneficial Provisions and require adequate disclosure of the information with acceptable burden. As we mentioned formerly, it is more user-friendly to provide information in accordance with Investor Beneficial Provisions. This way, investors could easily arrive at the point they need to know in timely manner.

IX. Comments on "Question:" on p.25

A. We basically feel empathy with the consideration pointed out in the "Question:" on p.25. But there may be no strong needs for the information with regard to the oversight/supervision of a credit rating agency that provided a rating for the issuer's ABS.

B. Now regulators are supervising credit rating agencies in their jurisdiction pursuant to new regulation framework set forth in light of the lessons learned from the subprime crisis, we think the information about the oversight/supervision of a credit rating agency will be available not so much by ongoing disclosure practices as by regulation practices. This way, investors can know the status of a credit rating agency that provided a rating for their ABS.

X. Concluding Remarks

A. With regard to ongoing disclosure requirements, we would like to stress that adequate rule-making based on the individual features of the securitized products and investors is essential. Mere rigid and standardized ongoing disclosure regulations by the authorities would lack the necessary case-by-case flexibility, and might place unnecessary burdens on transaction participants, leading to market stagnation.

B. In summary, overly strict, broad, and open-ended ongoing disclosure regulations and their uniform application to every publicly-offered ABS has substantive adverse side-effects which may lead to a freeze in the ABS market.

End of document.