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Comment on the International Organization of Securities Commissions (IOSCO)'s Consultation Report: "Global Developments in Securitization Regulation"

Japanese Bankers Association

We, the Japanese Bankers Association, would like to express our gratitude for this opportunity to comment on the Consultation Report: *Global Developments in Securitization Regulation*, released on June 7, 2012 by the International Organization of Securities Commissions (IOSCO).

We hope that our comments below will assist in the remaining work towards finalizing the principles by IOSCO.

[General Points]

The policy recommendations (such as strengthening of risk retention requirements and enhancement of disclosure) would have a significant impact mainly on the economic activities of securitization originators (corporates). If these proposed requirements impose an excessive burden on securitization originators (corporates), we are concerned that implementing such recommendations may hinder the sound recovery of securitization markets.

Therefore, in implementing the policy recommendations, it is imperative to consider situations unique to each jurisdiction in order to avoid over-regulation resulting in the decrease in issuance of securitization products and ultimately the contraction of entire securitization markets.

In addition, we would like to propose that the scope of regulated products/transactions should be narrowed down from the perspective of promoting effective and efficient regulations and sound practice of securities transactions. Specifically, the scope should be limited to public securitization products, excluding bilateral transactions including ABCP securitizations. A further recommendation is to have separate discussions on

domestic and cross-border transactions.

Application of broad regulations on a global and uniform basis may impact the markets and constrain even sound transactions which contribute to the stability of financial system, and consequently risks in market malfunction. In this context, we request that differences in regulations or practice across jurisdictions be fully taken into account, and the application of uniform regulations which ignore differences of local regulations or market practices of each jurisdiction be strictly avoided.

○ Treatment of bilateral transactions

In light of investor protection, we consider that securitization transactions structured on a bilateral basis between financial institutions and their customers may be excluded from the scope of application of the proposed requirements.

In Japan, securitization transactions of customer receivables engaged in by Japanese banks are considered to be alternative forms of bilateral loan transaction between financial institutions and their customers (i.e., a securitization product with private placement) where all risks are borne by financial institutions. This type of securitization product is fully guaranteed by financial institutions and no risk is transferred to external investors. Therefore, we believe it is not necessary to regulate this type of transactions, and thus consider it reasonable to scope it out of the application of the proposed requirements.

Moreover, under most securitization transactions that are executed on a bilateral basis, an originator and financial institution directly negotiate and determine terms and conditions. The financial institution – i.e. purchaser – can enter into such a contract with sufficient conditions, and monitor the transaction over its maturity. Due to such nature of this type of transaction, the Japanese securitization market has never faced issues arising from an originator's moral hazard even without a regulation requiring originators to retain risk.

With regard to the proposed disclosure requirements, the application of these requirements should be limited to securitization products only when parties involved in the transactions may benefit from such disclosure requirements – i.e. they should be applied only to securitization products other than those structured on a bilateral basis between financial institutions and customers. This is because in cases of bilateral

securitization transactions, no party will benefit from the disclosures with enhanced transparency and standardization; we consider that there is no merit in introducing the proposed disclosure requirements for such transactions.

In our understanding, except for RMBS issued by the Japan Housing Finance Agency, most securitization products are executed on a bilateral basis between a financial institution and its customer in Japan. In this type of securitization products which could be considered as an extension of bilateral transactions, an originator and financial institution could negotiate directly and address to disclosure matters on a case-by-case basis in a way that could satisfy the financial institution. This means that the financial institution does not unconditionally accept stress testing/scenario analysis executed by the originator. From this point of view, it is doubtful how such information would be beneficial in making investment decisions related to securitization products.

[Specific comments]

1. Issue One: Differences in approaches to risk retention

(1) More desirable approach

With respect to the risk retention requirements proposed in Issue One, we consider that the regulation should not apply different treatment to the retention of subordinated tranches. Instead, we recommend that these tranches shall be subject to appropriate disclosure, and investors' intention shall be reflected in the terms of issuance, including saleability (ease of sale) and financing costs.

In Japan, no particular regulations are imposed on the retention of subordinated tranches. However, it is common that an originator retains a subordinated portion in a securitization transaction structured for funding purposes for the following reasons: a sale of the subordinated shares will give rise to higher financing costs; while the originator will benefit from ongoing possession of the subordinated shares as it will generate excess earnings which will be received in a future period. On the other hand, it is understood that a transaction for which an originator does not retain subordinated shares may bring about moral hazard even from the standpoint of investors, and hence may discourage saleability of subordinated shares (causing difficulty in sales to investors). It is therefore basically preferable to run the market on a basis of natural laws, rather than governing the securitization market through imposing specific regulations.

(2) Classification and standardization of risk retention requirements

Securitization transactions, by their nature, may be classified into various categories based on criteria such as their purposes, entities involved, types of the underlying securitized assets (such as accounts receivable, notes receivable, auto loans, card loans and residential loans), a period over which receivables are collected (short-term, medium- to long-term, ultralong-term), subscription policy (individual-bilateral basis, private offering, public offering), tranching considering the regions where a transaction is structured and where a securitization product is sold, and sale/hedge. Risk profile also varies depending on these criteria.

For example, the securitization structure of notes receivables may enable collection of receivables without servicing of an originator for securitized receivables. On the other hand, in cases of securitization of medium- to long-term receivables and long-term receivables, we understand that an originator may often be requested to assume a certain level of burden, including pooling cash to cover a variety of costs arising from a change in a servicer in a cash reserve account at the initiation of the scheme.

Accordingly, we propose that approaches for risk retention shall be carefully assessed, considering the types of the underlying securitized assets and the collecting period in order to develop applicable requirements, and the various methods for retention shall be classified and standardized based on such requirements.

The level of disclosure should also be taken into account for determining the scope of exemptions. For example, we are concerned that the US exemption provisions (those that define conditions of LTV for residual loans and DSCR for commercial real estate loans) would lead to weakening in incentives for underlying securitized assets and securitization in some jurisdictions, ultimately reducing the volume of issuance of securitized products. Thus, we consider that it is more meaningful to develop exemption provisions according to the level of disclosure (for example, if the exemption is determined based on risk retention, a hair cut shall be defined for each level of disclosure).

(3) Defining a retention ratio (numerical threshold)

When implementing risk retention requirements, uniform definition of specific threshold, such as 5% floor of retention ratio, would not fit into the market practice in each jurisdiction.

The size of asset pool to be securitized, the number of exposures and the criteria for tranching depend on underlying assets as well as practices in each jurisdiction. For example, a rule on 5% minimum retention ratio exists in the EU and the US, while there is a rule in Japan that off-balance is not permitted for accounting purposes if an originator holds 5% or more of risk in a real estate securitization. If a uniform standard is introduced, we are concerned that the securitization market for particular assets may not effectively function in Japan.

If a uniform threshold were to be defined, considerations shall be made in line with each laws and regulation, accounting rule, market practice in each jurisdiction, instead of setting a uniform 5% minimum retention level.

(4) Considerations to be made to prevent particular investors from facing a disadvantage
The EU regulation may increase disadvantage for certain types of investors. Therefore, considerations should be made not to give rise to such a competitive disadvantage by regulating only particular investors.

(5) Treatment of credit and liquidity enhancements provided by a sponsor
With respect to ABCP, similar to treatment under the EU regulation, credit and liquidity enhancements by a sponsor should be permitted as one of the forms of risk retention, particularly in cases of full credit and liquidity enhancements.

Under the Dodd–Frank Wall Street Reform and Consumer Protection Act, credit and liquidity enhancements are not allowed as one of the form of risk retention. However, since the sponsor retains risk of underlying assets, the sponsors' interest coincides with the investors' interest, and hence credit and liquidity enhancements by a sponsor would satisfy the purposes of the requirement in this Consultation Report. Additionally, the differences in the regulation between the EU and the US may impose a burden and impede fair competition in cases where ABCP facilities are executed both in the EU and the US markets.

2. Issue Two: Improvement in Transparency – Disclosure of outcomes of stress testing/scenario analysis
(1) Consideration of impact on originators
We consider that transactions to be disclosed shall be determined by carefully assessing the approach for information disclosure requirement and the content of disclosure,

depending on the type of securitized assets and the collection period. The assessment also needs to take into account any impact on originators which will be the entity disclosing information.

From the standpoint of the originators, which are the customer, imposing additional costs and requiring additional disclosure items which originators are not willing to disclose may weaken the incentive for undertaking securitization. This may give rise to further concerns over stagnating the securitization markets.

In order to facilitate the development of the securitization market in Japan, we consider that it is crucial to take a viewpoint from creating a market environment that activates the issuance of securitized products by originators. Information on performance of assets that are generated from the core business of originators, including commercial receivables such as trade receivables and note receivables, lease receivables and card loans is equivalent to cost structure of the originators. Therefore, disclosure of stress scenarios associated with this information may entail considerable workload, but with no specific incentive for disclosing such information for originators.

(2) Development of disclosure guidance on stress testing and scenario analysis

As discussed above, although we recognize the significance of improving disclosure proposed under the policy recommendations in this consultation paper, the requirement to disclose the stress tests by issuers (or originators) shall not be included in the policy recommendations. We believe that the disclosure of stress testing and scenario tests by issuers (originators), if required, shall not be required unless industry standardized scenarios are developed and related assumptions are clarified.

We consider that how to carry out stress testing based on which scenarios and the severity of stress are rather matters for investors. Disclosure of outcome of stress testing and scenario analysis by originators, if required, may involve arbitrariness by the originator. Additionally, in the absence of standardized scenarios, requiring such disclosure may lead to the risk that investors may be misled in identifying and comparing risks. Data that will form a basis for stress testing shall be addressed in Issue Three in order to enhance disclosure. On the other hand, Issue Two shall focus more on enhancing opinions issued by rating agencies and the market monitoring.

It may also be practicable to include only high-level concepts in guidance, if any

guidance is to be developed, taking into account characteristics of assets in each jurisdiction.

We do not place much significance on issuing specific guidance as the disclosure method shall also depend on conditions unique to each jurisdiction.

(3) Necessity of sufficient information disclosure

We believe that, with the exception of transactions structured bilaterally between a financial institution and its customer, increasing the volume and enhancing quality of disclosure information is essential, and ongoing disclosure subsequent to investment as well as initial disclosure are crucial for investors to identify risks that they hold.

Although the number of securitized products by the private sector has been substantially reduced since the financial crisis in Japanese securitization market, we believe that at least adequate disclosure is required through the investment in order to restore the confidence in the securitization market and to attract and increase the number of both investors and issuers in this market regardless of types of securitization.

(4) Treatment of ABCP

ABCP with full credit and liquidity enhancements provided by a sponsor shall be exempted from the disclosure of stress testing.

If a sponsor provides full credit and liquidity enhancements, an investor focuses on the creditworthiness of the sponsor in assessing its investment. Therefore, as stated above, we believe that detailed disclosure of stress testing, required for transactions with no credit/liquidity enhancement, is not necessary for these transactions.

3. Issue Three: Standardization of disclosure

(1) Reconsideration of development of global-based standard disclosure templates

While we support the proposed concept of standardizing the disclosure for publicly offered securitized products, there is no need to develop standard templates on a global basis since asset characteristics vary among jurisdictions. Risks and key factors will differ depending on the types of securitized assets, collection period of receivables, policy to attract investors and other similar factors. In addition, the historical performance, originator's credit/collection policies and other similar factors differ by transaction. In this view, information to be disclosed should be tailored based on such

factors as necessary. Disclosure items, terminology and definitions should reflect a situation unique to each jurisdiction. Since there are differences in the definition monitored by each jurisdiction, disclosure items should be determined in light of disclosure practices of each jurisdiction. Moreover, it is essential to ensure consistency with existing disclosure regulations. In this respect, we consider it practically difficult to globally standardize the disclosure templates.

In Japan, the use of standard templates such as Standardized Information Reporting Package (SIRP) was discussed at the initiative of the securities industry. While a standard template was not created at that time, examples of recommended disclosure items were provided by asset class. Information to investors upon issuance and during the transaction period in the forms of securities information/asset information/stakeholder information was classified from a conceptual aspect. This initiative was supported and evaluated as useful. In implementing SIRP, there was a view that the development of a standard template did not necessarily contribute to stimulating markets, due to different characteristics by asset, establishment of standardizing indicators, the necessity/feasibility of system development/modification by each originator arising from implementing SIRP, and other issues.

We note that the consultation paper remains unclear on whether IOSCO intends to provide examples of recommended disclosure items by asset class through the proposed template as is the case of SIRP in Japan. We consider it possible to carry out a comparative analysis of recommended disclosure items (if any) by each jurisdiction, and make necessary adjustments; however certain differences in disclosure are expected to arise inevitably due to differences in the regulations of each jurisdiction. Therefore, instead of aiming for standardizing templates, we propose that some “principles” be provided and shared to ensure that originators disclose minimum information considering applicable laws and regulations in each jurisdiction.

(2) Treatment of ABCP

ABCP with full credit and liquidity enhancements provided by a sponsor shall be exempted from the disclosure of underlying asset information.

If a sponsor provides full credit and liquidity enhancements, an investor focuses on the creditworthiness of the sponsors in assessing a product to be invested. Therefore, as stated above, we believe that detailed disclosure of underlying asset information

required for transactions with no credit/liquidity enhancement is not necessary for these transactions.