

November 12, 2010

The Honorable Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.,  
Washington, D.C. 20549-1090

**Re: Comment on the Order Granting Temporary Conditional Exemption For Nationally Recognized Statistical Rating Organizations from Requirement of Rule 17g-5 Under The Securities Exchange Act of 1934 and Request for Comment**

Dear Madam Secretary,

The Securitization Forum of Japan respectfully submits its comments on the above referenced matter.

**I. Introduction**

- A. The securitization industry in Japan welcomes the Order Granting Temporary Conditional Exemption For Nationally Recognized Statistical Rating Organizations from the Requirement of Rule 17g-5 Under The Securities Exchange Act of 1934 (Release No.34-62120; File No.S7-04-09) dated May 19, 2010 (the "Exemption Order"). Our comments on the Exemption Order are based on the characteristics of the Japanese securitization market, its participants' business practices, and the regulatory framework surrounding credit rating agencies in Japan. Although we basically agree with the purposes and the proposed approach stated in the Exemption Order, we would like to point out our comments and concerns mainly focusing on the adaptability of the application of Rule 17g-5 (a)(3) of the Securities and Exchange Act of 1934 ("the Website Rule") in the Japanese market.
- B. We appreciate the Commission's decision to suspend the Website Rule by the Exemption Order. We respectfully ask that the Commission extends and expands such measures so that the application of the Website Rule will be exempted permanently, for cases where (i) the issuer is a non-U.S. person, and (ii) the structured finance product will be offered or sold upon issuance, or traded, outside the U.S.

**II. Background**

- A. According to the Website Rule, the following measures should be taken in cases where Nationally Recognized Statistical Rating Organizations (NRSROs) issue or maintain credit ratings for a

structured finance product<sup>1</sup> that is paid for by the issuer, sponsor, or underwriter of the structured finance products.

- (a) NRSROs should maintain a password-protected Internet Website with a list of each structured finance product for which it is currently in the process of determining an initial credit rating, and provide free and unlimited access to any NRSRO providing the certification herein under (iii).
- (b) NRSROs should obtain from the issuer, sponsor, or underwriter of a written representation that can reasonably be relied upon, that affirms that it:
  - (i) Posts and maintains all information provided to NRSRO for the purpose of determining or monitoring the credit rating at an identified pass-word protected Internet Website at the same time such information is provided to NRSROs.
  - (ii) Provides access to such password protected Internet Website during the applicable calendar year to any NRSRO that provides it with a copy of the certification indicated at (c).
- (c) In order to access a password-protected Internet Website, NRSROs must furnish to the Commission, for each calendar year, the following certification signed by a person duly authorized by the certifying entity.
  - (i) It will access the Internet Website described in the Website Rule solely for the purpose of determining or monitoring credit ratings.
  - (ii) It will keep the information it accesses pursuant to the Website Rule confidential and treat it as material nonpublic information, and,
  - (iii) It has determined and maintained credit ratings for at least 10% of the structured finance products for which it accessed information pursuant to the Website Rule in the calendar year, or has previously not accessed information 10 or more times during the most recently ended calendar year.

B. We understand that the Website Rule was implemented for the purpose of facilitating the issuance of unsolicited ratings for the structured finance products and serves to mitigate the potential for ratings shopping<sup>2</sup>. We also understand that such Website Rule will be applied not only to the NRSRO, but also to its Japanese affiliate, if any, listed on item 3 or item 1-B of Form NRSRO.

C. On the other hand, such credit rating agency (“the Credit Rating Agency”) that is registered under the Japanese Financial Instrument and Exchange Law (Law No. 25 of 1948, as amended, the “FIEL”) will also have to comply with the Japanese regulations aiming to prevent ratings shopping<sup>3</sup>.

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<sup>1</sup> The security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument.

<sup>2</sup> See Release No.34-61050 “Amendment to Rules for Nationally Recognized Statistical Rating Organizations” (Federal Register page 63844)

<sup>3</sup> Article 306-(1) (ix) of Cabinet Office Ordinance on Financial Instruments Business, etc.

The following measures have to be implemented so as to enable a third party, as an independent party, to verify the appropriateness of the Credit Rating, in cases where the object of the Credit Rating is the assessment of the credit status of any Asset Securitization Products:

- (a) measures to itemize information that may be deemed valuable in an assessment by a third party of the appropriateness of the Credit Rating and to announce such information;
- (b) measures to encourage Rating Stakeholders to implement measures to enable a third party to verify the appropriateness of the Credit Rating, such as an announcement of information on the Asset Securitization Products including the items announced pursuant to sub-item (a) above : and.
- (c) measures to announce the details of the encouragement taken by the Credit Rating Agency pursuant to sub-item (b) above, as well as the result thereof (meaning the result of the interviews with the Rating Stakeholders in relation to the status of the disclosure of information on the Asset Securitization Products).

Where the Website Rules apply not only to a corporation in the United States but also to a Japanese affiliate, the Credit Rating Agencies and the Arrangers will be forced to take both the measures required under the SEC Rules and under the FIEL, which measures are different in content, but are required for the same purpose, the prevention of potential issues arising from ratings shopping, thus resulting in the issue of double regulation.

- D. In response to a substantial number of comments received from various entities and countries, the Commission released the Exemption Order of May 19, 2010 that states that NRSROs are exempt until December 2, 2010 from the requirements of the Website Rule in the case where it fulfills the following requirements.
  - (a) The issuer of the security or money market instrument is not a U.S. person (as defined under Securities Act Rule 902 (k));and
  - (b) The NRSRO has a reasonable basis to conclude that the structured finance product will be offered and sold upon issuance, and that any arranger linked to the structured finance product will effect transactions of the structured finance product after issuance, only in transactions that occur outside the U.S.
  
- E. The European Commission released a website rule similar to the Website Rule and such EU website rule is under discussion in the Parliament, however, the scope of the application is limited to the credit rating agencies registered in the European Union<sup>4</sup>.

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<sup>4</sup> See Article 8b.1 of the Regulation of the European Parliament and of the Council on amending Regulation (EC) No.1060/2009 on credit rating agencies

### **III. SFJ's Comments on the Exemption Order**

#### **A. General Comment**

For the following reasons, SFJ respectfully requests that the Commission extend the exemption of the application of the Website Rule to make it a permanent rule even after December 2, 2010. We think that the Commission should avoid applying the Website Rule extraterritorially at least in cases where the corresponding financial instruments are not issued by a U.S. person, nor offered or sold to the investors in the United States.

#### **B. "Ratings shopping" in Japan should be prevented by compliance with the Japanese regulations**

For the following reasons, SFJ thinks that potential issues arising from ratings shopping in Japan should be prevented by compliance with the Japanese regulations.

##### **(a) NRSROs will not be capable of issuing the credit ratings related to the Japanese structured finance products**

In order to issue credit ratings on Japanese securitization products, a credit rating agency will need to have sufficient knowledge and expertise with regard to the credit risk pertaining to the Japanese market and with regard to the business, economic, legal and regulatory environment peculiar to Japan. However, NRSROs, other than those that are established in Japan or that have Japanese affiliates, will not be likely to have the ability to issue credit ratings related to the Japanese structured finance products, because they will not have adequate resources to produce appropriate credit ratings relating to Japanese structured finance products, as the US registration requirements of NRSROs do not require such kind of resources pertaining to Japan. Thus, it is very likely that only the credit rating agencies registered with the Financial Services Agency in Japan will have the ability to issue credit ratings related to Japanese structured finance, but such Credit Rating Agencies do not have a custom of issuing unsolicited credit ratings on structured finance products in Japan as described B (b) (ii). Given such situation, it will be too burdensome for Arrangers in Japan to bear the costs of disclosing information on the website to prepare for the unlikely incident that other NRSROs request information in order to issue unsolicited credit ratings. There is little necessity to oblige the Japanese arrangers to disclose confidential information to the US NRSROs that may not have an adequate ability to evaluate the credit rating of Japanese structured finance products, taking into account the risk of leakage of information through the Internet or through such NRSROs that are not supervised by the Japanese regulators.

##### **(b) The Ratings Shopping in Japan Regulation for the prevention of ratings shopping under the Financial**

**Instruments and Exchange Law is in accordance with the IOSCO Code of Conducts**

- (i) The Website Rule is aimed at facilitating the issuance of unsolicited ratings for structured finance products and serves to mitigate the potential for ratings shopping<sup>5</sup>. For the same purpose of avoiding “ratings shopping”, the FIEL prescribes the provisions against the ratings shopping as described above II C. Such provisions are based on Article 2.8 (c) of the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies, which is the international code for the credit rating agencies.
  - (ii) We understand such provision prescribed based on the market conditions around credit rating business in Japan. In Japan, all registered Credit Rating Agencies adopt the issuer-pays business model, and such Credit Rating Agencies do not have the custom to issue unsolicited credit ratings on structured finance products in Japan. In addition, we further understand that the Credit Rating Agencies currently do not intend to issue the credit ratings that are paid to other credit rating agencies.
  - (iii) Considering such situation, such prescription would not use the Website approach but to make the condition that market participants (not limited to the credit rating agencies) would evaluate whether the rating issued by the Credit Rating Agency is appropriate or not.
  - (iv) Considering the market conditions around the credit rating business in Japan, SFJ thinks that the issue of ratings shopping would not be mitigated by using the Website approach, and ratings shopping in Japan should be prevented by compliance with the Japanese Regulation.
- (c) The extraterritorial application issues regarding the FIEL and the EU regulation**

According to both the FIEL and EU regulation, the application of both laws to credit rating agencies located outside of the country is limited to a reasonable scope.

According to the Comprehensive Guidelines for Supervision of Financial Instrument and Business Operators, etc. (Supplement Guidelines for Supervision of Credit Rating Agencies), it is prescribed that credit ratings, which are determined at an overseas location by a credit rating agency that is a foreign corporation and which satisfies each of the following conditions, are defined as the non-Japanese related ratings, and the Financial Instruments and Exchange Act will not apply to such non-Japanese related ratings:

- i) The rating is not a credit rating of a financial instrument that is premised on solicitation by financial instrument business operators, etc. in Japan

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<sup>5</sup> See Release No.34-61050”Amendment to Rules for Nationally Recognized Statistical Rating Organizations” (Federal Register 63844 page)

- ii) The Rating Stakeholders are not domiciled within Japan
- iii) In the case of asset securitization products, the main underlying assets are not located in Japan.

According to the EU regulation, credit rating agencies that are governed by the EU Website Rule are limited to credit rating agencies registered in the Union (Article 8b.1).

**C. The application of the Website Rule will have serious negative effects on the Japanese securitization market**

If the Website Rule were to apply to the securitization products issued in Japan for Japanese investors, such application would have serious negative effects on the Japanese securitization market and would prevent the Japanese market participants from properly evaluating and supervising credit ratings.

- (a) The Japanese securitization market is not as mature as the United States market, and the number of structured finance products being issued is substantially smaller compared to what is being observed of the United States market. Actually, according to a survey by the Japan Securities Dealers Association, issuance of securitized products (excluding MBS issued by Japan Housing Agency) between April 2009 and March 2010 was approximately 1,2 trillion Japanese yen. In the Japanese financial intermediation market, indirect financing, such as borrowing from financial institutions plays a much larger role than direct financing, such as securitization. In addition, the costs of issuing plain corporate debt (corporate bonds and commercial paper) and of borrowing from financial institutions are, in particular, currently in decline and are generally becoming more favorable for potential issuers or borrowers compared to securitization. If the Website Rule were applied to Japanese securitization products and related parties were to bear additional costs to comply with the Website Rule, we are of the view, based upon extensive discussions with market participants, that the transaction volume and transaction parties (issuers and investors) in the securitization market will substantially diminish. This would result in a decrease in the number of the market participants that evaluate and supervise credit ratings issued by the Credit Rating Agencies thus providing market discipline. Therefore, the application of the Website Rule to securitization products in Japan will adversely affect the original policy intention of prevention of ratings shopping because the market participants that criticize and discipline credit ratings will decrease.
- (b) With regard to the trade receivables securitization products that the regional banks arrange to bundle for small enterprise originators, the Arrangers are likely to cease to obtaining credit ratings on such products or to arrange securitization products altogether.
- (c) In Japan, five credit rating agencies (three of which are based outside of Japan, including US based NRSROs, and two are Japanese based) act as the main players and currently provide

the market with appropriately competitive conditions. However, if the Website Rule were to apply to securitization products in Japan, requests for issuing credit ratings would become concentrated on non-NRSRO Credit Rating Agencies registered with Japan's Financial Services Agency in accordance with the FIEL (including affiliates of NRSROs that are not deemed as NRSROs). This would possibly distort the competitive conditions for credit rating agencies in Japan.

- (d) In relation with the updating of credit ratings, necessary information is usually submitted by the originator, not by the arranger, to the credit rating agency. Originators of small enterprises in particular will not likely be able to comply with the Website Rule, because it is too costly for such small enterprises.

**D. An application of the Website Rule would cause serious problems with regard to confidential information**

**(a) The problem with regard to confidential agreements**

The information required to be disclosed according to the Website Rule, may include highly confidential information. However, NRSROs other than those which are either established in Japan or have an affiliate registered in Japan, do not have any substantial trading record in Japan, and it is very difficult for the Japanese market participants to check the governance mechanism of such other NRSROs to treat confidential information. Under such conditions, the arranger or originator will likely limit the amount of information submitted to the credit rating agency as little as possible. Considering such Japanese market conditions, an application of the Website Rule to the securitization products in Japan will result in the decline of the amount and quality of the information submitted to credit rating agencies and, therefore, in the decline of the quality of the credit ratings.

**(b) The security problem of the Arrangers' Web site**

In cases where the arranger prepares the website (the Arranger's Website"), the originators will require a high level of security. A level of security that satisfies all originators is not clear, and the arranger should take steps to assure a very high security level for its Website. Such preparations give rise to high costs for the Arranger. If the originator casts doubt on the security level, the originator will cease to provide financing through securitization or will limit the information submitted to the NRSRO. This would lead to a decline in the quality of credit ratings.

**E. Conclusion**

As described above, if the Website Rule is applied to the securitization products arranged in Japan, issued in Japan, and offered and sold in Japan, and not offered and sold to the investors in the United States,

it would have a serious negative impact on the Japanese securitization market. Moreover, despite such application, it would not likely prevent rating shopping in Japan, which is the stated purpose of the Website Rule and, conversely, it would have a harmful effect on the evaluation and supervision of the quality of the credit ratings issued on the Japanese securitization market.

Therefore, SFJ respectfully asks that the Commission exempts the application of the Website Rule permanently, even after December 2, 2010, in cases where (i) the issuer is a non-US person, and (ii) the structured finance product is offered or under transaction outside the U.S.

Thank you for the opportunity to comment on the Order and the Website Rule. Should you have any questions or desire additional information regarding any of the comments set out above, please do not hesitate to contact us:

Yours faithfully

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