

April 17, 2009

**Comment on the Consultative Document for “Proposed enhancement to Basel II Framework”
issued by the Basel Committee on Banking Supervision**

Securitization Forum of Japan

The Securitization Forum of Japan (“SFJ”) is an organization established in Japan in January 2005. SFJ’s purpose is to promote the sound development of securitisation in Japan (i) by discussing and considering various issues concerning securitisation, (ii) by making policy recommendations based on the results of discussions and consultations, (iii) by building a network of academics and business/industry experts, and (iv) holding seminars and similar events. SFJ is the only organization in Japan in which a cross-section of securitisation market participants, such as banks, securities companies, other financial institutions, rating agencies, lawyers, accountants and academics, participate. It is a great honor for us to have an opportunity to present our comments on the Consultative Document for the “Proposed enhancement to Basel II Framework” (the “Proposed Enhancement”) to the Basel Committee on Banking Supervision (the “Committee”). We hope that our opinions expressed herein will further the finalization of new rules.

At first, as far as the issue concerns securitisation, we believe that the Proposed Enhancement will help to develop a sound securitisation market in Japan, and very much agree with its spirit. We understand that the Proposed Enhancement requires the banking sector to implement adequate capital charge and adequate risk management practices with respect to securitized assets, since the subprime crisis / financial crisis revealed these as major issues regarding securitized assets.

However, in order to make the spirit more effective, we would like to ask the Committee to ensure a proper balance between the purposes and the actual regulations. As is well known, securitisation has strong fundamental merits such as (i) diversifying financing sources, especially for non-banks, etc., and (ii) functioning as a risk diversification tool for bank groups. With respect to (i), it is true that the securitisation of sub-prime loans under the immoderate originate-to-distribute business model in the U.S. etc. was one of the reasons leading to the financial crisis. Nevertheless, as the Committee understands, the problem is not securitisation itself, but how to use it. We believe that the importance of the functions of securitisation is still recognized. For example, the fact that the Term Asset-Backed Securities Loan Facility (TALF) was launched in the U.S. to support non-banks to raise funds through securitisation, and to smoothly provide funds to consumers, etc. confirmed the importance of securitisation.

With respect to (ii), it is undeniable that repeated resecuritisation has problems such as, risks are masked or systemic risks are magnified. Needless to say, inappropriate practices should be eliminated and the problems, including those mentioned above, need to be resolved. On the other hand, we believe that securitisation, which blocks the risk of the originator (initial risk holder) and enables it to distribute its risk to investors with various risk preferences, are still essential for the diversification and activation of financial markets. We believe that securitisation itself continuously plays an important role in developing a sound financial system. As such, we consider that it is not desirable that the securitisation market shrinks excessively. In particular, since the securitisation market in Japan is less developed compared to those of Europe and the U.S., we are afraid that excessive regulation might result in a shrinking of the market, more so than is desirable. On this basis, we would like to present our comments as follows.

1. The Proposed Enhancement’s Potential to Send a Message

We understand that the Proposed Enhancement aims to strengthen the weaknesses in banks’ risk management that were revealed during the financial crisis that began in 2007, and that it mainly targets particular areas of securitisation products. However, we have some concern that the new rules may

be an over-reaction to the recent financial crisis, and it would appear that the initiative to strengthen overall regulation of securitisation products is too strong. As is well known, regulations send strong messages to the entire market, especially because Basel II regulations are deeply involved in daily operational aspects.

As such, we are concerned that the entire securitisation market may react excessively to the new rules. As stated above, we believe that the development of a sound securitisation market will be essential for the whole financial system in the future. If the Committee accepts our view, we would like to ask the Committee to write down a clear statement in the new document that the spirit of the Proposed Enhancement is to develop a sound securitisation market, and that the Committee does not see the securitisation products themselves and/or the securitisation market itself as a problem.

2. Pillar 1

(1) Resecuritisation Risk Weights

Based on reflections from the recent financial crisis, it is important for market participants to recognize the risks involved in complicated securitisation products, and to perform appropriate risk management assessments. Therefore, we agree in general terms that higher risk weights should be applied to complicated, so-called, “resecuritisation products” than those for traditional securitisation products.

However, the definition of “resecuritisation” that the Committee proposes is likely to include products that are not necessarily suitable for treatment as “resecuritisation products” for the purposes of risk management. Securitisation products include those structured in a number of different ways, and some products will likely fall under the definition that the Committee proposes as a matter of form.

In consideration of the spirit of the Basel Accord, which states that “the capital treatment of a securitisation exposure must be determined on the basis of its economic substance rather than its legal form (para. 538),” we would like to propose that the Committee incorporates a provision to the effect that “whether a product falls under the definition of a resecuritisation product is determined on the basis of its economic substance” into the section setting forth the definition of “resecuritisation”. Furthermore, we would like to ask the supervisory authority of each country to make, based on such spirit, the appropriate supervision of their own markets.

(2) Operational Requirements for Credit Analysis

Information gathering as described in “Operational criteria for credit analysis” of the Proposed Enhancement to determine the risks is necessary for market participants in order to understand the risks of securitisation products. We believe that if such information gathering becomes a common practice for market participants, it leads to the development of a sound securitisation market.

(2-A) Request of Clarification of “Illustrative” Purposes

However, the necessary information differs from one securitisation product to another, and therefore, the items of information specified in the Proposed Enhancement may in some cases be insufficient or, on the other hand, may in other cases, too much.

We understand that the items of information specifically stated in the Proposed Enhancement are only for “illustrative” purposes, and we would like to confirm whether our understanding is correct. If our understanding is correct, we would like to ask the supervisory authorities of each country to take a flexible approach in their supervisory practices, depending on the nature of the relevant securitisation products, and taking into account the differences in the characteristics of products in the relevant jurisdiction.

(2-B) Grandfathering Clauses

Unfortunately, the existing securitisation products include many products for which appropriate information is not available or is difficult to gather. It would be excessive regulation to require the exposure to be entirely deducted from the capital in such cases. Such a requirement might cause further turmoil of the market in light of the recent circumstances in the securitisation market. Therefore, we would like to request some grandfathering clauses for existing securitisation products.

(2-C) Flexible Approach concerning the Timing of the Commencement

In addition, because preparation of necessary information and data in various regions and for various products are in different stages, we would like to request a flexible approach, to the extent possible, concerning the timing of the commencement of the application of these rules to new products, taking into account the progress of the preparation of necessary information and data, and conversations with the private sector.

(2-D) Supplemental Discussion: Trading Book

Additionally, although matters concerning the trading book are outside the scope of comments to be submitted this time, we noted that the Proposed Enhancement states that a practice similar to that for the banking book should be applicable to the trading book. However, information gathering may not work well in the case of the trading book, for which a trading decision must be made in a short period of time. As such, we would like to request that the nature of the business concerning the trading book be taken into account when implementing supervisory practices concerning the trading book, although we do not mean that we should neglect to understand or determine the risks just because the relevant products are held in the trading book.

3. Pillar 2

(1) Firm-wide risk oversight

We do not have any particular comment on this matter. We agree on the purpose of this section.

(2) Specific risk management topics (especially, B. Off-balance sheet exposures and securitisation risk, C. Reputational risk and implicit support, and F. Sound stress testing practice)

The risk of off-balance sheet exposure concerning securitisation was revealed during the recent financial crisis. It is undeniable that this risk was one of the causes aggravating the recent financial crisis. We understand that the Proposed Enhancement is based on reflections from this, and agree on the framework of the Proposed Enhancement. However, the extent of risks of off-balance securitisation exposures or reputational risks can not be measured quantitatively, and most of those risks are measured only by scenario analyses in stress tests, as proposed by the Committee. In the case of the recent financial crisis, it is a fact that it became a serious problem because the occurrence of these risks was not predicted, even in such stress tests. (For example, we heard that the securitisation market functioned effectively at the time of the collapse of the dot-com bubble, and the September 11 attacks, and the liquidity facilities for ABCP conduits were rarely drawn down.)

Therefore, keeping in mind the purpose of Pillar II, we would like to request that the Committee recognize certain limitations of the stress test, and that the supervision of the management of the risks of these exposures not be excessive, while at the same time maintaining conversations with the private sector.

4. Pillar 3

Undeniably, the indefiniteness of risks concerning exposures to securitisation products was one of the causes resulting in the recent distrust of financial institutions, and the financial crisis. On this basis,

we agree with strengthening the disclosure relevant to such exposures. With respect to the disclosure level, we have heard that analysts in the financial sector believe that disclosure at this level is adequate (neither too much nor too little) to analyze the creditability of financial institutions.

On the other hand, since practices of such disclosure in Japan have been advanced, banks in Japan already practice disclosure of information at a level set out in the Proposed Enhancement. However, since securitisation exposures themselves caused concerns in the market about the credit worthiness of financial institutions, many financial institutions have preferred to adopt an approach claiming that they did not have securitisation products, including non-problematic securitisation products, as the disclosure regulations have been strengthened. As a result, investors in securitisation products dramatically decreased and the securitisation market excessively shrank.

We believe that such tendencies will be rectified eventually when the market calms down and recognizes again the necessity of non-problematic securitisation products. However, as described in Section 1 above, we would request that the Committee fully pays attention to the potential of the Proposed Enhancements to send a message to the market, and that the Committee clarify that the recent strengthened framework aims only to develop a sound securitisation market, and that the Committee does not see the securitisation products themselves and/or the securitisation market itself as a problem.

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